

NATIONAL TAXPAYER ADVOCATE

# ANNUAL REPORT TO CONGRESS

Volume 1

2016





*This report is dedicated*

*to*

*Tom Beers*

*TAS research advisor*

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*from whom I have learned so much,  
and without whom this Report  
would not be what it is today.*

*I am grateful for his friendship, his  
sage advice, and his refreshing honesty.*

*We all wish him well in retirement.*



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## PREFACE: Introductory Remarks by the National Taxpayer Advocate

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### HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate's 2016 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

During 2016, I and the Taxpayer Advocate Service embarked on an extraordinary endeavor of actively engaging with the taxpayers we serve. As I announced in last year's Annual Report, where we analyzed the IRS's vision for its Future State, I traveled the country and held 12 Public Forums on Taxpayer Needs and Preferences.<sup>1</sup> Together with Members of Congress, I heard directly from taxpayers and their representatives about the challenges they face complying with the tax laws and dealing with the IRS.<sup>2</sup> TAS also held "Future State" Focus Groups with tax preparers and practitioners at the IRS's Nationwide Tax Forums.<sup>3</sup> And we engaged every single TAS office in meetings about the Future State, asking our employees what they thought taxpayers needed now and in the future.<sup>4</sup> Finally, we conducted a nationwide survey of U.S. taxpayers to learn what they need in the way of taxpayer service.<sup>5</sup>

All of this has been a very humbling and moving experience — to see so many people caring so much about improving tax administration, taking the time to attend the Public Forums, sharing their ideas, and expressing their concerns, including the universal acknowledgement that the IRS needs more funding to do its job. For me, it was a transformative experience. More specifically, it has motivated me to lay out my vision and recommendations for what the IRS needs to be a world-class 21st century tax administration, based on all of the information people have shared with me this year. This vision is set forth in the first section of the Report, titled "Special Focus," and it is arguably the most important piece I have written about the IRS in my 15 years serving as National Taxpayer Advocate.

In addition to the Special Focus section, we have included a third volume of the Report (after our usual Volume Two containing TAS research studies). At the beginning of 2016, I charged my immediate staff with identifying significant research into topics that have relevance for tax administration, including approaches to voluntary compliance, worldwide taxpayer service, alternative dispute resolution, taxpayer

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- 1 National Taxpayer Advocate Public Forums were held in the following locations: San Antonio, TX (Aug. 30, 2016); Los Angeles, CA (Aug. 22, 2016); Portland, OR (Aug. 18, 2016); Parma, OH (Aug. 16, 2016); Washington, DC (May 17, 2016); Baltimore, MD (May 13, 2016); Red Oak, IA (May 5, 2016); Harrisburg, PA (Apr. 8, 2016); Hendersonville, NC (Apr. 4, 2016); Bronx, NY (Mar. 18, 2016); Chicago, IL (Mar. 9, 2016); and Washington, DC (Feb. 23, 2016).
  - 2 For information about and full transcripts from the National Taxpayer Advocate Public Forums, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Dec. 31, 2016).
  - 3 TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts About IRS's Proposed Future State* (Oct. 2016).
  - 4 For the results of the discussions with TAS employees, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Dec. 31, 2016).
  - 5 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

rights, fraud detection, online accounts appearance, and geographic focus.<sup>6</sup> I asked that they not limit their review to tax literature, but to look at psychology, organizational theory, network theory, marketing, and other disciplines. As a result, Volume 3 contains comprehensive Literature Reviews on several tax administration topics. We used this research as groundwork for many of the Most Serious Problems herein; we wanted to look at the IRS in a broader context, and the Literature Reviews have enabled us to bring insights from other disciplines and other countries and apply them to IRS problems and challenges.

In light of the arrival in January 2017 of a new Administration and a new Congress, our first two Legislative Recommendations include recommendations pertaining to tax reform — the first identifying the burdens the current tax code places on taxpayers and the IRS alike, and suggesting that Congress undertake comprehensive tax simplification; the second proposing a comprehensive revamp of the tax code’s “family status” provisions to reduce taxpayer burden and combat improper payments. Simply put, the IRS cannot achieve a transition to a 21st century tax administration if it is encumbered by a 20th century tax code. Thus, we hope this Report, and the analysis and recommendations it contains, will prove helpful to the Administration and to Members of Congress this year and your consideration of tax and IRS reform. As always, I stand ready to assist in any way that I can.

Respectfully submitted,



Nina E. Olson  
National Taxpayer Advocate  
31 December 2016

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6 See Literature Reviews: *Taxpayer Service in Other Countries*; *Incorporating Taxpayer Rights into Tax Administration*; *Behavioral Science Lessons for Taxpayer Compliance*; *Geographic Considerations for Tax Administration*; *Customer Considerations for Online Accounts*; *Options for Alternative Dispute Resolution (ADR)*; and *Reducing “False Positive” Determinations in Fraud Detection*, vol. 3, *infra*.

## SPECIAL FOCUS

### IRS FUTURE STATE: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration

#### INTRODUCTION

In the 2015 Annual Report to Congress (ARC), the National Taxpayer Advocate identified the IRS's plans for its "Future State" as the number one most serious problem facing taxpayers.<sup>1</sup> Among other things, she cited concerns about the IRS's lack of transparency with taxpayers and Congress about the plans; the move away from person-to-person assistance and compliance contacts in favor of impersonal electronic "self-service;" and the reliance on private third parties to provide for-fee assistance for core tax administration services previously provided by the IRS for free, thereby increasing taxpayer costs for the "privilege" of paying their taxes.

The IRS has partially addressed the National Taxpayer Advocate's concerns. For example, almost immediately after the issuance of the Annual Report to Congress, the IRS created a webpage on [irs.gov](https://www.irs.gov) dedicated to the "Future State" and uploaded numerous documents.<sup>2</sup> The IRS Commissioner also made clear in congressional testimony and elsewhere that the IRS did not intend to eliminate phone or in-person assistance.<sup>3</sup> Moreover, during the Nationwide Tax Forums this summer, the IRS held a presentation on the "Future State," attended by over 2,200 practitioners and preparers, and also sponsored a suggestion booth.<sup>4</sup>

These steps, however commendable, have not fully addressed the core of the National Taxpayer Advocate's concerns, namely, that the IRS has failed to adequately study and incorporate into its "Future State" plans the needs and preferences of United States taxpayers — an incredibly diverse and complex population. In a budget environment in which the IRS has seen its annual appropriation decreased by about 19 percent on an inflation-adjusted basis, it is tempting and even understandable for the IRS to try to move taxpayers

- 1 National Taxpayer Advocate 2015 Annual Report to Congress 3-13 (Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*).
- 2 IRS, <https://www.irs.gov/uac/newsroom/irs-future-state> (last visited Dec. 20, 2016).
- 3 "As we improve the online experience, we understand the responsibility we have to serve the needs of all taxpayers, whatever their age, income, or location. We recognize there will always be taxpayers who do not have access to the internet, or who simply prefer not to conduct their transactions with the IRS online. The IRS remains committed to providing the services these taxpayers need. We do not intend to curtail the ability of taxpayers to deal with us by phone or in person." *Tax Return Filing Season: Hearing Before the H. Subcomm. on Oversight, Comm. on Ways and Means*, 114th Cong. (Apr. 19, 2016) (written statement of John Koskinen, Commissioner, Internal Revenue Service). See also *Can the IRS Protect Taxpayers' Personal Information? Hearing Before the H. Subcomm. on Research and Technology, Comm. on Science, Space and Technology*, 114th Cong. (Apr. 14, 2016) (statement of John Koskinen, Commissioner, Internal Revenue Service), <https://www.irs.gov/uac/written-testimony-of-commissioner-koskinen-before-the-house-science-space-and-technology-committee-on-cybersecurity-and-protecting-taxpayer-information>, and John A. Koskinen, Commissioner of Internal Revenue, Address Before the National Press Club (Mar. 24, 2016), <https://www.irs.gov/uac/March-24-2016-Commissioner-Koskinen-Speech-to-National-Press-Club>.
- 4 10,723 practitioners and preparers attended the IRS Nationwide Tax Forums. Of those, 2,263 attended the presentation "IRS Future State Initiative" at five Tax Forums in 2016. Email from IRS Office of Online Services to TAS (Dec. 13, 2016).



to less costly methods of communication, or channels, including digital self-service options.<sup>5</sup> But as tax administrators throughout the world have learned, and as the National Taxpayer Advocate discusses in this annual report, many of these shifts are only superficially less costly.<sup>6</sup> This is so because even the best-designed digital environment cannot accommodate the sheer complexity of the tax code and the limitless variety of taxpayers' lives and circumstances. This constrained communication, coupled with automated impersonal and often harmful IRS actions, can alienate the taxpayer population and over time may undermine compliance. Even if there is no negative compliance impact (which the National Taxpayer Advocate does not believe), it is not a recipe for good government if a large portion of U.S. taxpayers are alienated from and distrustful of the one government agency they interact with at least annually throughout their adult lives.

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... even the best-designed digital environment cannot accommodate the sheer complexity of the tax code and the limitless variety of taxpayers' lives and circumstances.

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For these reasons, and given her statutory role as “an independent voice for the taxpayer within the IRS,”<sup>7</sup> in this Special Focus, the National Taxpayer Advocate has attempted to identify and make recommendations to address the challenges the IRS faces to become a 21st century, taxpayer-centric tax administrator. The first and most obvious is the compelling need for tax reform. In our first legislative recommendation, *Simplify the Internal Revenue Code Now*, we describe in detail the burdens the current, hideously complex Code imposes on taxpayers and the IRS alike. But suffice it to say here that a Code consisting of four million words<sup>8</sup> and requiring six billion hours of taxpayer time when meeting their filing requirements<sup>9</sup> is simply too complex to administer well. Add to that the fact that the federal government “spends” more money through the tax code each year than it spends to fund the entire federal

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- 5 In FY 2010, the agency's appropriated budget stood at \$12.1 billion. For FY 2016, its budget was \$11.2 billion, a reduction of nearly eight percent over the six-year period. Inflation over the same period is estimated at nearly 11 percent. See Office of Management and Budget, *Fiscal Year 2016 Budget of the U.S. Government, Historical Tables* (230-31), Table 10.1, <https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/hist.pdf> (showing Gross Domestic Product (GDP) and year-to-year increases in the GDP). In addition, the IRS has had to implement the statutory requirements of the Patient Protection and Affordable Care Act and the Foreign Account Tax Compliance Act during this time, causing a further drain on its resources.
  - 6 See Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations* and Literature Review: *Taxpayer Service in Other Countries*, vol. 3, *infra*.
  - 7 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 48 (June 25, 1997).
  - 8 To determine the number of words in the Internal Revenue Code (IRC), TAS downloaded Title 26 of the U.S. Code (*i.e.*, the IRC) from the website of the U.S. House of Representatives, <http://uscode.house.gov>. We copied the file into Microsoft Word, and used the “word count” feature to compute the number of words. The online version of Title 26 we used was current through December 12, 2016. In Word, the document ran 10,928 single-spaced pages. The printed code contains certain information that does not have the effect of law, such as a description of amendments that have been adopted, effective dates, cross references, and captions. The word count feature also counts page numbers, the table of contents, and the like. Therefore, our count somewhat overstates the number of words that are officially considered a part of the tax code, although as a practical matter, a person seeking to determine the law will likely have to read and consider many of these additional words, including effective dates, cross references, and captions. Other attempts to determine the length of the Code may have excluded some or all of these components, but there is no clearly correct methodology to use, and we found no easy way to selectively delete information from a document of this length.
  - 9 The TAS Research function arrived at this estimate by multiplying the number of copies of each form filed for calendar year 2015 by the average amount of time the IRS estimated it took to complete the form. While the IRS's estimates are the most authoritative available, the amount of time the average taxpayer spends completing a form is difficult to measure with precision. This TAS estimate may be low because it does not take into account all forms and, as noted in the text, it does not include the amount of time taxpayers spend responding to post-filing notices, examinations, or collection actions. Conversely, the TAS estimate may be high because IRS time estimates have not necessarily kept pace fully with technology improvements that allow a wider range of processing activities to be completed via automation.



government through the appropriations process.<sup>10</sup> Clearly, the Internal Revenue Code (IRC) is due for an overhaul.

In Public Forums, Tax Forum Focus Groups, and TAS Workgroups, two other broad themes emerged. First, ours is a voluntary compliance system that rests on the cooperation of taxpayers, large and small. It requires engagement with taxpayers. For taxpayers to be engaged, the IRS needs to *talk to the taxpayer!* Here is how one TAS employee stated it: “Sometimes nothing can replace the sound and the tone of a human voice, especially in a crisis situation. IRS must present a human side to the agency to foster and keep voluntary compliance.”<sup>11</sup>

The last broad theme is the need for establishing minimum standards of and testing for competency of federal tax return preparers. The National Taxpayer Advocate has long recommended a pragmatic oversight regime designed to protect U.S. taxpayers from unscrupulous and incompetent return preparers.<sup>12</sup> She reiterates that recommendation here, and notes that without such standards and oversight, the entire tax system is at risk.

In addition to these three foundational themes, there are several other areas of tax administration requiring attention before the IRS can become a world-class 21st century tax administration. These challenges include:

- **IRS Budget and Oversight:** To fairly, effectively, and efficiently administer the tax system, the IRS must receive increased funding, but such funding should be tied to additional congressional oversight of IRS strategic and operational plans;

10 In FY 2016, the Treasury Department estimated “tax expenditures” amounted to more than \$1.4 trillion. At the same time, discretionary appropriations amounted to less than \$1.2 trillion. The federal budget consists of discretionary spending for government operations that Congress sets through annual appropriations acts and mandatory spending that is established through eligibility and benefit formulas, such as Social Security and Medicare benefits, as well as interest on the federal debt. For FY 2016, appropriated funds totaled about \$1.17 trillion. See Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2016 to 2026*, Table 1-3 (Aug. 2016), <https://www.cbo.gov/sites/default/files/51118-2016-08-BudgetProjections.xlsx>. For a list and description of tax expenditures, see Office of Tax Analysis, U.S. Department of the Treasury, *Tax Expenditures* (Sept. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2018.pdf>. The Joint Committee on Taxation also publishes estimates of tax expenditures. There are some differences in methodology between the Treasury Department’s methodology and the Joint Committee’s methodology, and the Joint Committee’s most recent estimate of tax expenditures for FY 2016 was more than \$1.3 trillion — also greater than federal appropriations but somewhat less than the Treasury Department’s estimate. See J. COMM. ON TAX’N, JCX-141R-15, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019* (Dec. 2015), <https://www.jct.gov/publications.html?func=startdown&id=4857>.

11 TAS, *Executive Briefing, Future State Discussion Analysis* 41 (Sept. 2016). Here is more wisdom from TAS employees: The Future State completely changes the expectations that the taxpaying public can have of the IRS. These taxpayers have always known they could come to an IRS walk-in office or call the IRS toll-free line in order to have their questions answered. However, this is a change in the basic “contract” between the IRS and the taxpaying public. This means that some taxpayers will be comfortable and confident in their ability to understand the tax law and meet their obligations, while other taxpayers will likely feel “left behind” in the Future State. *Id.* at 18.

And:

You can’t replace verbal communication and excel in voluntary compliance, nor customer service. *Id.* at 23.

12 National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78; National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remains Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

- **IRS Culture:** To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented;
- **IRS Mission Statement:** To ensure the IRS recruits, hires, and trains employees with the appropriate skill sets, the IRS must revise its mission statement to explicitly acknowledge the IRS's dual mission of collecting revenue and disbursing benefits, as well as the foundational role of the Taxpayer Bill of Rights;
- **Understanding Taxpayer Needs and Preferences:** To ensure that the IRS designs its Current and Future State initiatives based on actual taxpayer needs and preferences, the IRS must actively and directly engage with the taxpayer populations it serves as well as undertake a robust research agenda that furthers an understanding of taxpayer compliance behavior;
- **Taxpayer Rights and the Future State:** To ensure that taxpayer rights, and the Taxpayer Bill of Rights specifically, are the foundation for tax administration the IRS should undertake a comprehensive review of key taxpayer rights provisions in the IRC and issue proposed guidance for public comment, updating these provisions to protect taxpayer rights in the digital environment envisioned by the IRS Future State;
- **Grossly Outdated Technology and Infrastructure:** To enable the IRS to meet the major technology improvements required for a 21st century tax administration, even as it fulfills current operational technology demands, the IRS must articulate a clear strategy that will reassure Congress and taxpayers the funding will be well-spent; and
- **Office of the Taxpayer Advocate:** To protect taxpayer rights and ensure a fair and just tax system, Congress should take steps to strengthen the Taxpayer Advocate Service.

The National Taxpayer Advocate has listed the need for additional IRS funding and oversight first because without adequate funding, taxpayers are being and will be harmed by the “efficiencies” the IRS imposes to deal with budget reductions. However, she links the IRS need for more funding with the need for more congressional oversight of the agency’s priorities. Congressional oversight is necessary to ensure that the IRS appropriately allocates and applies that funding, and that taxpayer needs — not just the agency’s internal needs — are met.

To achieve the appropriate level and allocation of IRS funding, in the sections that follow, the National Taxpayer Advocate identifies and discusses key elements that must be addressed, including a change in IRS culture from enforcement-focused to service first. We must embed taxpayer rights into every aspect of the agency's mission. We must understand how to improve taxpayer morale, including what factors influence taxpayer compliance behavior and what taxpayers need and prefer in order to meet their tax obligations. Similarly with tax reform — we must understand compliance behavior even as we legislate tax policy. Otherwise, we will pass laws with which taxpayers cannot comply.

In writing this Special Focus, the National Taxpayer Advocate has relied heavily on the wealth of information obtained throughout 2016 from her 12 Public Forums on Taxpayer Needs and Preferences; focus groups with practitioners and preparers about the “Future State” held at five Nationwide Tax Forums; and discussion meetings held with all employees in each office of the Taxpayer Advocate Service (TAS). All of these materials, including full transcripts of the Public Forums, are available to the public at <https://taxpayeradvocate.irs.gov/public-forums>. In addition, we include in Volume 2 of this report the interim findings of a nationwide taxpayer survey about their needs and preferences.<sup>13</sup> Thus, to an unusual extent for government, the analysis and recommendations presented here reflect the perspectives of taxpayers and their representatives, as well as the combined experience of the National Taxpayer Advocate and her employees, whose job it is to advocate for taxpayers.

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<sup>13</sup> See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

**IRS BUDGET AND OVERSIGHT: To fairly, effectively, and efficiently administer the tax system, the IRS must receive increased funding, but such funding should be tied to additional congressional oversight of IRS strategic and operational plans.**

Simply put, the IRS cannot function well in the 21st century with the budget it has today. More funding is paramount — for taxpayer service, for compliance functions, for the agency’s enforcement function (Criminal Investigation), for technology, and for its “support” operations like security and real estate.

The National Taxpayer Advocate has served in her position for over 15 years, and she has witnessed firsthand how IRS officers and employees struggle to meet the often competing demands placed on them by new legislation, congressional priorities, natural and other emergencies, the identity theft epidemic, and taxpayer needs and preferences. Each year the IRS must deliver a filing season in which it processes some 150 million individual tax returns and issues over 115 million refunds totaling over \$345 billion,<sup>14</sup> while guarding against between \$22 and \$24 billion in identity theft and refund fraud.<sup>15</sup> At the same time, it must incorporate new legislative changes — almost 5,900 since 2001, an average of more than one a day<sup>16</sup> — and major new programs like the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA). Thus, the IRS spreads thin the resources it has, and every decision to apply resources in one place means that another area goes begging. Understandably, it focuses on what it considers its major obligations — the filing season, new legislation, and the area of information technology and cybersecurity. The consequences of this “big item” focus are that smaller, important, taxpayer-facing service is reduced or eliminated, including the community presence of education and outreach, Taxpayer Assistance Centers (TACs), compliance personnel, and Appeals officers. For example:

- Despite the IRS’s increased ability to handle taxpayer calls using automation, the percentage of calls the IRS answered from taxpayers seeking to speak with a telephone assistor dropped from 87 percent to 53 percent between fiscal year (FY) 2004 and FY 2016.<sup>17</sup> Among the callers who got through, the average time spent waiting on hold increased from just over 2.5 minutes in FY 2004 to nearly 18 minutes in FY 2016.<sup>18</sup> Comparing FY 2004 with FY 2016, the number of calls the IRS received from taxpayers on its Accounts Management telephone lines increased from 71 million to 104 million, yet the number of calls answered by telephone assistants declined from 36 million to 26 million.<sup>19</sup>
- In 2014, the IRS ceased all tax preparation in the TACs and eliminated post-April 15 tax law phone and TAC assistance.
- The IRS has also reduced the number of TACs (also known as walk-in sites) from 401 to 376 (six percent) since 2011.<sup>20</sup> Additionally, 22 TACs have no staff, and 95 have only one employee.<sup>21</sup>

14 IRS Pub. 55B, IRS Data Book 2015 (Mar. 2016), Tables 2, 7 and 8. Figures are for FY 2015.

15 Treasury Inspector General for Tax Administration, Ref. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2* (Apr. 24, 2015).

16 For an in-depth discussion of the need for tax reform and the methodology of this calculation, see Legislative Recommendation: *Simplify the Internal Revenue Code Now*, *infra*.

17 Compare IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016) with IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2004). The Accounts Management telephone lines (previously known as the Customer Account Services telephone lines) receive the significant majority of taxpayer calls. However, taxpayer calls to compliance phone lines and certain other categories of calls are excluded from this total.

18 *Id.*

19 *Id.*

20 In 2011, the IRS operated 401 TACs. IRS response to TAS information request (Dec. 23, 2014). Today the IRS operates 376 TACs, a reduction of six percent. IRS response to TAS fact check (Dec. 20, 2016).

21 IRS response to TAS fact check (Dec. 20, 2016).

- Sixteen states have no Appeals or Settlement Officers present within their boundaries, and 14 states have no IRS liaisons to Small Business/Self-Employed taxpayers within their boundaries.<sup>22</sup>

Figure S.1 shows the reduction in IRS geographic presence and employees between 2011 and 2016.

**FIGURE S.1, Locations With Specified Employees in the Last Pay Period of the Fiscal Year<sup>23</sup>**

| Number of Locations, Employees, or Visitors                              | 2011   | 2012   | 2013   | 2014  | 2015  | 2016  |
|--|--------|--------|--------|-------|-------|-------|
| IRS Offices (Cities)   | 541    | 523    | 510    | 499   | 479   | 470   |
| Appeals Officers (AOs)   | 1,129  | 1,058  | 958    | 881   | 795   | 739   |
| Revenue Officers (ROs)   | 4,402  | 4,035  | 3,703  | 3,441 | 3,191 | 3,072 |
| Revenue Agents (RAs)   | 11,959 | 11,258 | 10,502 | 9,776 | 9,090 | 8,871 |
| Stakeholder Liaison Outreach Employees                                   | 137    | 123    | 119    | 110   | 105   | 98    |
| Stakeholder Partnerships, Education and Communication Outreach Employees | 522    | 475    | 444    | 405   | 386   | 365   |
| Taxpayer Assistance Centers (TACs)                                       | 401    | 401    | 398    | 382   | 378   | 376   |
| TAC Service Reps   | 1,639  | 1,515  | 1,484  | 1,520 | 1,423 | 1,267 |

At the same time, taxpayer returns and forms filed increased between tax year (TY) 2011 and TY 2015. Overall, filings grew nearly four percent from 234,567,000 in TY 2011 to 243,249,000 in TY 2015.<sup>24</sup>

We discuss the effects of this reduction in our Most Serious Problems, herein, on the structure of the IRS and the lack of a geographic presence in communities.<sup>25</sup>

- 22 Appeals response to TAS information request (June 6, 2016). Puerto Rico lacks an Appeals or Settlement Officer in addition to the 16 states. IRS response to TAS fact check (Dec. 15, 2016). IRS Human Resources Reporting Center, *Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees* as of the week ending October 1, 2016 (report generated Dec. 1, 2016). The District of Columbia lacks an IRS liaison in addition to the 14 states. See Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*, *infra*.
- 23 Figures for Appeals Officers, Revenue Officers, Revenue Agents, Stakeholder Liaison Outreach, SPEC Outreach, and Taxpayer Assistance Center (TAC) Service Representatives are from the IRS response to TAS fact check (Dec. 16, 2016). TAC customer service representative figures are from the IRS Human Resources Reporting Center, *Position Report by Employee Listing for the ending pay period for FY 2011 to 2016*, Nov. 2, 2016. The IRS response to TAS Fact Check (Dec. 16, 2016) showed the following counts for TAC customer service representative: Fiscal Year (FY) 2011 – 1,977, FY 2012 – 1,839, FY 2013 – 1,775, FY 2014 – 1,803, FY 2015 – 1,678, and FY 2016 – 1,477. TAS was unable to replicate the IRS TAC employee figures. TAC Office figures for FYs 2011–2014 from IRS response to TAS fact check (Dec. 23, 2014). TAC Office figures for FY 2015 from Wage and Investment (W&I) analyst (Dec. 13, 2106). TAC Office figures for FY 2016 from the IRS response to TAS fact check (Dec. 20, 2016).
- 24 IRS, *Databook Returns Filed Tax Year (TYs) 2011-2015* (Nov. 30, 2016). This total includes individual income tax returns, business-entity income tax returns, employment tax returns, estimated tax forms, and certain other returns and forms.
- 25 See Most Serious Problems: *IRS Structure: The IRS's Functional Structure Is Not Well-suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, and *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*, *infra*. See also Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.

### *Downstream Costs of IRS Budget Cuts Can Outweigh Savings, Increase Taxpayer and IRS Burden, and Erode Taxpayer Trust*

Far too often, in response to budget constraints, the IRS makes penny-wise, pound-foolish decisions. For example, the recently announced revised rules about the limited availability of face-to-face Appeals conferences, and changes to settlement authority of certain Appeals' personnel, has led to criticism from key tax professional groups.<sup>26</sup> The National Taxpayer Advocate personally provided several suggestions to the Chief of Appeals and other senior Appeals officials that, if adopted, would address many of Appeals' concerns about wise use of resources while not vitiating the taxpayer's *rights to appeal an IRS decision in an independent forum and to a fair and just tax system*.<sup>27</sup> Instead, far from reducing overall costs, Appeals' proposed procedures will increase costs for both the IRS and the taxpayer by shifting issue resolution to more expensive litigation venues or downstream to the IRS compliance functions or the Taxpayer Advocate Service, increasing unnecessary rework. Either way, taxpayer confidence in and patience with the IRS is eroded.

Initiatives designed to save IRS resources are too often focused inward on the IRS's own needs — how it can gain cost savings in one area so it can reapply them elsewhere. Again, while this is understandable in the present environment, it is not right. These decisions do not adequately take account of taxpayer needs and preferences, taxpayer burden, or the downstream costs incurred because taxpayers have not received the assistance they need.

For example, over the last two years, the IRS has been moving slowly to an appointment-only system for assistance in the TACs. These locations were formerly known as “walk-in centers,” but for all intents and purposes, in the 2017 filing season, the IRS will not be accepting “walk-ins.” While the National Taxpayer Advocate has long recommended the IRS offer taxpayers the *option* of making appointments, she is opposed to making TACs available *exclusively* by appointment.<sup>28</sup> The following testimony from the National Taxpayer Advocate Public Forum in San Antonio illustrates the myopia of this policy:

[S]everal months ago I had a client that I was assisting to help make sure that he did not get a lien filed. And so from that perspective he had filed a 2014 tax return and underpaid by several hundred thousand dollars.

Well, he settled that case and came into the money that he needed to pay to the IRS. So I said, okay, well, cut me the check made out to the IRS, folks, of course. And, and I will go

26 See, e.g., Letter from Joan C. Arnold, American College of Tax Counsel, to Kirsten Wielobob, Chief Appeals (Oct. 10, 2016); Coalition for Effective and Efficient Tax Administration, letter to Kirsten Wielobob, Chief Appeals (Oct. 21, 2016); Memorandum from Kenneth M. Horwitz, Texas Society of Certified Public Accountants to Commissioner of Internal Revenue (May 13, 2016) (Preserving and Improving Access to Face-to-Face Appeals Conferences). See also Statement of Jaime Vasquez, Chamberlain, Hrdlicka, White, Williams & Aughty, National Taxpayer Advocate Public Forum 52 (Aug. 30, 2016):

So what I've seen is that cases that don't need to go to [T]ax [C]ourt can be resolved with the IRS appeals office. And with the cutback of the number of local IRS appeals officers, what's happening is that people's cases are getting shipped to IRS campus offices where they're not getting a face-to-face person who can help resolve their case. And you know, as we all know, sometimes when you're dealing with someone face to face walking them through the particular records and their life circumstances, cases tend to be resolved. These are why such things as mediations are so successful.

27 For a detailed discussion of our concerns about the Office of Appeals concept of operations, see Most Serious Problem: Appeals: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its “Future Vision” Should Incorporate Those Values, *infra*.

28 See National Taxpayer Advocate 2014 Annual Report to Congress 122-33 (Most Serious Problem: Access to the IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues); National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 42-45; National Taxpayer Advocate 2012 Annual Report to Congress 302-18 (Most Serious Problem: The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services).



and walk it into the IRS office. Well, that was just when I found out that that local office had just been closed. So there I was with a [\$240,000] check and, you know, I was like, you know, I made several phone calls. No success.

And after a week of sitting with this \$240,000 check, I was getting really embarrassed, of course. No one wants to sit on that much, you know, money for, for someone else. Finally got in touch with an IRS revenue officer who put me in touch with the collection officer for the day who said that, and who had finally, they could accept the [\$240,000] check. And I thought to myself, you know, this is ridiculous.

You know, here I am trying to, you know, help my client getting in compliance with the IRS and we can't even pay the IRS.<sup>29</sup>

### *The Role of Congressional Oversight in Achieving Effective 21st Century Tax Administration*

As stated above, the IRS has to make difficult choices every day, and those choices have consequences for taxpayers and tax administration. The National Taxpayer Advocate believes there are many things the IRS can do to apply its resources more effectively, particularly with respect to compliance initiatives (indeed, the National Taxpayer Advocate publishes over 1,000 pages a year, via her Annual Reports to Congress, identifying areas for improvement and making recommendations). But the simple fact remains, even with these improvements, the IRS needs more funding. It cannot become a 21st century tax administration without adequate support from Congress.

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**Sometimes nothing can replace the sound and the tone of a human voice, especially in a crisis situation. IRS must present a human side to the agency to foster and keep voluntary compliance.**

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That support is not just financial. The National Taxpayer Advocate believes there is a key role for congressional oversight both as a preliminary to and a consequence of additional funding. This oversight should focus on the effectiveness of IRS service and compliance activities with respect to the 150 million individual taxpayers and ten million business taxpayers, especially small businesses and self-employed individuals. Is the IRS availing itself of the most important insights of behavioral science?<sup>30</sup> For example, during the first two weeks of January before the 2016 filing season, the National Taxpayer Advocate sent out about 7,100 letters to taxpayers who had claimed the Earned Income Tax Credit (EITC) on their 2014 returns but whose claims were flagged by the IRS Dependent Database (DDb) as being highly questionable. The IRS did not audit these taxpayers because of insufficient resources. The letters were strictly educational and tailored to the specific rule “broken” by the taxpayer; they were written in a helpful tone and clearly stated the taxpayer was not under audit. These letters had a statistically significant positive impact on the EITC compliance of this group of taxpayers. Thus, projected against the population of EITC filers who violated these particular rules, for the cost of a letter and postage, the IRS could prevent \$47 million in EITC noncompliance.<sup>31</sup> TAS is repeating this test in the 2017 filing season; in this version, we will be offering some EITC taxpayers

29 Statement of Jaime Vasquez, Chamberlain, Hrdlicka, White, Williams & Aughtry, National Taxpayer Advocate Public Forum, 48-49 (Aug. 30, 2016).

30 For a discussion of the application of behavioral insights to tax administration, see *Most Serious Problem: Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *infra*. See also *Literature Review: Behavioral Science Lessons for Taxpayer Compliance*, vol. 3, *infra*.

31 For a copy of the letters sent, and a detailed discussion of this research study, see *Research Study: Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Education Letter from the National Taxpayer Advocate*, vol. 2, *infra*.

a dedicated “Extra Help” line in which trained TAS employees will answer taxpayer questions *before* the taxpayers file their returns.

Nevertheless, the IRS relies on audits as its primary compliance tool for maintaining reporting compliance — closing nearly 874,000 individual taxpayer audits in FY 2016, with 84 percent of those through correspondence.<sup>32</sup> To understand the effectiveness of this application of resources, we need to know what percentage of IRS audits result in no change, by type of audit. Research has shown that when an audit results in no change, the taxpayer is more likely to report less income in the future.<sup>33</sup> Where there is an assessment, what percentage of audits are reopened later as audit reconsiderations, resulting in unnecessary downstream re-work? Of the audits that result in a Tax Court case, what percentage are settled — and why — by IRS Appeals or Chief Counsel employees? How much audit activity results in future voluntary compliance? Since the point of an audit is not just to assess additional tax but to ensure that the same errors or positions do not occur again, what percentage of audited taxpayers understand why the adjustments were made? These are just a few of the questions that overseers should be asking of the IRS to ensure that current and additional funding is spent wisely and effectively.

As part of the reorganization mandated by Congress in the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Congress held joint annual hearings, over five years, to review the IRS strategic plan.<sup>34</sup> The hearing participants included three members (two majority and one minority) from each of the congressional committees with jurisdiction over the IRS — Senate Finance Appropriations, and Governmental Affairs; and House Ways and Means Appropriations and Governmental Reform and Oversight. The hearings were to cover the following topics:

- (1) IRS progress in meeting its objectives under its strategic and business plans;
- (2) IRS progress in improving taxpayer service and compliance;
- (3) IRS progress on technology modernization; and
- (4) The annual filing season.<sup>35</sup>

The National Taxpayer Advocate recommends that Congress reinstitute this commendable practice. By holding recurring joint oversight hearings, the IRS will have the opportunity to articulate, with specificity, its need for additional resources and its plans for applying them. Hearing from both the IRS and outside experts — including tax professional organizations, business representatives, Low Income Taxpayer Clinics, and behavioral scientists — Congress will better understand the challenges that both the IRS and taxpayers face. It can then make informed decisions about the level and general application of resources necessary for the IRS to provide U.S. taxpayers with a 21st century tax administration they can trust and admire.

32 IRS, Compliance Data Warehouse, Automated Information Management System (AIMS) Closed Case Database.

33 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 67-98 (Research Study: *Audit Impact Study*); National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 27-42 (Research Study: *Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Results*).

34 Pub. L. No. 105-206, § 4001, enacting IRC § 8021(f), and § 4002, amending IRC § 8022, 112 Stat. 685, 783-84 (1998).

35 H. REP. No. 105-364, at 84-85 (1997). The Restructuring Commission earlier recommended that Congress create a joint committee on IRS administration, which would conduct joint hearings on similar topics. National Commission on Restructuring the IRS, *A Vision for a New IRS* 2-3 (June 15, 1997).



## Recommendations

The National Taxpayer Advocate recommends that Congress:

- Reinstate the joint review of the IRS strategic plans and budget provided for under IRC §§ 8021(f) and 8022.
- Require the IRS to submit a comprehensive “Future State” plan that describes, in sufficient detail, its vision for a 21st century IRS, including an explanation of how that vision meets the needs and preferences of different U.S. taxpayer segments, and describes the challenges and obstacles the IRS faces in achieving this “Future State.”
- Provide funding for IRS initiatives that enhance and maintain voluntary compliance, align with the specific needs and preferences of taxpayers as they attempt to comply with the tax laws, and eliminate unnecessary downstream re-work.

**IRS CULTURE: To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented.**

In its *Snapshot of A Better Way for Tax Reform* blueprint, the House Republicans' Tax Reform Task Force describes "A Service First IRS," noting that "[a] simpler, fairer tax code will require a simpler, fairer IRS with one mission: Put the taxpayers first."<sup>36</sup> Congress has addressed this issue before. In the IRS Restructuring and Reform Act of 1998 (RRA 98), it directed the IRS to "restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs."<sup>37</sup>

Yet today, the IRS's annual appropriation of \$11.2 billion allocates 43 percent to Enforcement, with only 21 percent attributable to taxpayer service. Of the \$2.3 billion allocation for Taxpayer Service, 73 percent is attributable to operational items like receiving and processing tax returns and payments, and only 27 percent is attributable to functions such as outreach and education.<sup>38</sup> In other words, outreach and education activities constitute less than six percent of the IRS budget.

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If a tax agency views its primary mission as "enforcing" the tax laws, it will design its procedures and apply its resources to "hunt down" those taxpayers it views as noncompliant.<sup>39</sup> It justifies this approach by rationalizing that law-abiding taxpayers want to know that all taxpayers are paying their fair share. The problem with this approach is that it undermines the willingness of taxpayers to comply by focusing most of its resources on those who are not willing to comply. Taxpayers who are willing to comply are left without adequate support.

In an enforcement-oriented tax agency, if taxpayers don't get the help they need to comply and they make a mistake, they are treated as if they are tax evaders. This treatment in turn breeds resentment and increases the risk that the taxpayer who was willing to comply is no longer willing to do so. In this way, the underlying assumption by the tax agency that taxpayers will evade tax becomes a self-fulfilling proposition. The agency ends up converting a compliant taxpayer into a noncompliant one.<sup>40</sup>

What if the tax agency adopted a different approach toward taxpayers? What if it assumed that taxpayers, by and large, wanted to obey the law and that the primary mission of the tax agency was to facilitate that compliance by providing taxpayers with the assistance, education, and clarity they need to meet their tax obligations? What if we started out accepting that taxpayers will make mistakes and, until proven otherwise, assume those mistakes are not attributable to a tax evasion motive? This matters because tax noncompliance, like most human behavior, is driven by a broad spectrum of factors, from just plain

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36 House Republicans' Tax Reform Task Force, *A Better Way for Tax Reform*, [http://abetterway.speaker.gov/\\_assets/pdf/ABetterWay-Tax-Snapshot.pdf](http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-Snapshot.pdf).

37 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998).

38 Consolidated Appropriations Act, 2016, Pub. Law 114-113, enacted Dec. 18, 2015. FY 2016 Operating Plan, Integrated Financial System (IFS).

39 See Written Statement of Pam Olson, PricewaterhouseCoopers, National Taxpayer Advocate Public Forum 20-22 (Feb. 23, 2016):

Those of you who know me know that I've not been fond of use of the word enforcement when it comes to the IRS because I think enforcing the law is an action that compels people to do something and it is not something that has to be visited on the average taxpayer. The average taxpayer wants to voluntarily comply and we just need to make sure they have the tools and the resources to do it. They may need advice or assistance but rarely do they need an enforcement action to compel them to pay their tax or to punish them for failing to do so.

40 For a discussion of the drivers of voluntary compliance, see Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called "Enforcement" Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *infra*.

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This is not to say we should ignore those who are actively evading tax. Rather, it is to say we should *design* our tax system around the taxpayers who are trying to comply, instead of those who are actively trying not to.

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carelessness to ignorance to confusion to polemics to avarice. By focusing on the source or reasons for a taxpayer's noncompliance, and not just on the end result of the behavior, we have a better chance of changing the behavior and improving tax compliance going forward.<sup>41</sup>

This is not to say we should ignore those who are actively evading tax. Rather, it is to say we should *design* our tax system around the taxpayers who are trying to comply, instead of those who are actively trying not to.

### *Bringing About a Cultural Shift: You Get What You Measure*

The National Commission on Restructuring the IRS summarized the agency's culture in this way:

The culture of IRS is overly risk averse, based on a tradition of valuing checks and controls over creative approaches to solving problems. In order to evolve into a more taxpayer focused, responsive organization, a cultural shift must occur at the IRS. The positives of the culture are that employees will execute orders and follow directions. The negatives are that the IRS environment often does not encourage personal or organizational growth, and stifles creativity, innovation, and quick problem resolution.<sup>42</sup>

Changing an organization's culture begins with understanding what drives employees' and officers' behavior. Basically, you get what you measure. The IRS's own annual announcement of measures and successes reflects this enforcement-heavy mentality — enforcement dollars assessed (via liens and levies), enforcement dollars collected, liens filed, levies issued.<sup>43</sup> It includes five pages of “enforcement” results and only one page — six items — of taxpayer service results. There is no mention of how much in the way of tax or penalties are abated annually because they were incorrectly or inappropriately assessed, or how many TAS cases resulted in full or partial relief, or how many outreach or education events were held in-person so that IRS employees and officers (including those in the audit and collection functions) could hear directly about taxpayer concerns. The IRS does not track how many people were turned away from TACs (formerly known as “walk-in sites” but now appointment-only).<sup>44</sup>

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41 See Written Statement of Leslie Book, Professor, Villanova Law School, National Taxpayer Advocate Public Forum 55 (Feb. 23, 2016):

I think, however, getting back to trust and how that relates to taxpayers there is no question that sanctions alone is really not the way, a sanctioned based approach is not the only way to encourage voluntary compliance. There needs to be an emphasis on insuring that interactions with taxpayers enhances trust and trust between the taxpayer and the IRS is a two-way street but if the taxpayers have an absence of trust in what the IRS is doing it leads to kind of spirals and increases non-compliance.

42 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 12-13 (June 25, 1997).

43 IRS, *Fiscal Year 2015 Enforcement and Service Results*, <https://www.irs.gov/uac/newsroom/fiscal-year-2015-enforcement-and-service-results>.

44 Since 2014, the National Taxpayer Advocate has published in the Annual Report to Congress a “report card” on the IRS, listing measures that would give a sense of whether the IRS is treating taxpayers right. This list of measures is organized under each of the ten taxpayer rights stated in the Taxpayer Bill of Rights and could serve as a starting point for a more comprehensive and balanced set of performance measures. See *Taxpayer Rights Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights*, *infra*.

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If we want IRS employees to focus on increasing taxpayer confidence and trust in the tax system, if we want taxpayer to feel engaged in the tax system they are all a part of, then we need to find ways to encourage and reward the IRS workforce for engaging with the population and viewing the taxpayer as a partner in trying to achieve or maintain voluntary compliance.

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If we want IRS employees to focus on increasing taxpayer confidence and trust in the tax system, if we want taxpayers to feel engaged in the tax system they are all a part of, then we need to find ways to encourage and reward the IRS workforce for engaging with the population and viewing the taxpayer as a partner in trying to achieve or maintain voluntary compliance.<sup>45</sup>

Notwithstanding the ubiquitous use of the term “enforcement” throughout IRS training, guidance (including the Internal Revenue Manual), and testimony, there is only one true “enforcement” function in the IRS, and that is the Criminal Investigation function. Every other taxpayer-facing part of the IRS is in the business of serving the taxpayer by encouraging voluntary compliance. Yes, there are some employees who utilize tools that compel action, like liens and levies. But activities such as audits and appeals should be viewed first and foremost as educational opportunities, not “enforcement” mechanisms. In an audit, the IRS can learn about the challenges taxpayers face in complying with the laws, and taxpayers can learn about what, in the eyes of the IRS, they reported incorrectly on the return. In some instances, taxpayers can learn that they can’t get away with something they thought they could; on the other hand, the IRS might just learn that it was wrong about an issue, or actually change its position on an aspect of tax law.

As we discuss in the Most Serious Problem about IRS structure herein, the greatest economies for a service-oriented organization are achieved by operating as small units that are located in the proximity of their customers.<sup>46</sup> Through structural design, performance measures, and, most importantly, training that reinforces engagement with the taxpayer and understanding taxpayer needs and preferences, the IRS can promote voluntary compliance and become a respected and appreciated federal agency.

### Recommendation

The National Taxpayer Advocate recommends that the IRS publish an annual report card on comprehensive measures that not only show traditional “enforcement” measures but disclose how the IRS performed in providing assistance and service in meeting taxpayer needs and preferences, as well as increasing voluntary compliance over time. These measures, in turn, should form the basis for Executive performance commitments and assessments.

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45 See Written Statement of Elizabeth Atkinson, LeClair Ryan, National Taxpayer Advocate Public Forum 29 (May 13, 2016):

Our tax code is very, very complicated and it’s better for the IRS to be in a position of listening to the taxpayer than having an authoritarian type of regime that not only makes the taxpayer feel like he or she is not being listened to, but sometimes leads to incorrect results and downstream compliance problems because the person is so turned off to the tax system by their experience, they don’t feel like complying anymore.

46 See Most Serious Problem: *IRS Structure: The IRS’s Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *infra*.

**IRS MISSION STATEMENT: To ensure the IRS recruits, hires, and trains employees with the appropriate skill sets, the IRS must revise its mission statement to explicitly acknowledge the IRS’s dual mission of collecting revenue and disbursing benefits, as well as the foundational role of the Taxpayer Bill of Rights.**

In RRA 98, Congress directed the IRS to restate its mission statement with an emphasis on taxpayer service.<sup>47</sup> Accordingly, the IRS adopted the following mission statement: “Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and *by applying the tax law* with integrity and fairness to all.”<sup>48</sup> (Emphasis added.) In 2009, with no public discussion, the IRS quietly made a profound change to that mission statement, which now reads: “Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and *enforce the tax law* with integrity and fairness to all.” (Emphasis added.) As noted in the preceding discussion of IRS culture, this shift in tone and emphasis, from “apply” to “enforce,” has significant consequences for taxpayers, and is closely related to the issue of agency culture.

A second problem with the agency’s current mission statement is its failure to acknowledge and articulate that the 21st century IRS has two specific lines of business: both revenue collector and benefits administrator. The IRS collects over \$3 trillion annually and issues over \$403 billion in refunds.<sup>49</sup> The Earned Income Tax Credit (EITC), a refundable credit for low and moderate income working families and individuals, accounts for almost \$67 billion in credits paid to 27 million taxpayers.<sup>50</sup> The tax code is increasingly used to promote various social and economic policies through the mechanism of tax credits and other tax expenditures.<sup>51</sup> Taking an enforcement-oriented approach to these inherently complex provisions, instead of one based on problem identification and understanding of the root causes of noncompliance, can deter eligible taxpayers from claiming benefits to which they are entitled under the law and prevent ineligible taxpayers from understanding what they did wrong.

Instead, by explicitly recognizing the IRS’s role as a benefits administrator in its mission statement, the IRS will have to rethink how it conducts major aspects of its work.<sup>52</sup> To fulfill this aspect of its mission, it will have to hire employees whose skills are better suited for this educational and compliance work. Thus, for the EITC and other tax provisions specifically targeted to the low income population, the IRS will have to hire or train employees with skills that are drawn from the social work profession.<sup>53</sup> These

47 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998).

48 IRM 1.1.1.1.1 (Mar. 1, 2006).

49 IRS Pub. 55B, IRS Data Book 2015 (Mar. 2016), Table 1. Figures are for FY 2015.

50 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc> (last visited Dec. 31, 2016). For Tax Year 2015, 27.3 million taxpayers had claimed \$66.9 billion in EITC (after math error processing, but prior to any audit of the tax return). IRS, Compliance Data Warehouse, *Individual Returns Transaction File* (includes Tax Year 2015 returns posted as of cycle 47).

51 For a discussion of the complexity and lack of transparency these provisions create, see Legislative Recommendation: *Simplify the Internal Revenue Code Now*, *infra*. For recommendations about reforming the EITC and other Family Status provisions, see Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *infra*. The National Taxpayer Advocate has previously discussed design elements that should be considered when running social benefit programs through the tax code. See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, 75-104 (*Running Social Programs Through the Tax System*).

52 See Statement of Pam Olson, PricewaterhouseCoopers LLP, National Taxpayer Advocate Public Forum 47 (Feb. 23, 2016): I think the most important thing is for the IRS to fully embrace the multifaceted responsibilities that it has with respect to both collecting tax as well as administering benefit system and administering lots of other things and making sure that it is factoring that into how it plans its service.

53 For a detailed discussion of the challenges faced by EITC taxpayers, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

employees will have the skills not only to employ interviewing techniques that are designed to elicit information without fear, but also to focus on educating the taxpayer going forward.

Finally, the IRS mission should explicitly acknowledge that the Taxpayer Bill of Rights (TBOR) underlies all of its actions. As we discuss later in this report, while the IRS has done a commendable job publicizing the TBOR to taxpayers, it still has considerable work to do integrating the TBOR in the life, training, and ethos of the agency.<sup>54</sup> Explicit mention in the mission statement would reinforce to IRS employees, and reassure taxpayers, that the TBOR is a guiding principle for all IRS actions.

### Recommendation

The National Taxpayer Advocate recommends that the IRS revise its mission statement to re-emphasize a non-coercive approach to tax administration, recognize the IRS's dual roles of revenue collector and benefits administrator, and explicitly affirm the role of the TBOR as the guiding principle for tax administration.

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54 See Most Serious Problem: *Taxpayer Bill of Rights (TBOR): The IRS Must Do More to Incorporate the TBOR into Its Operations*, *infra*.

**UNDERSTANDING TAXPAYER NEEDS AND PREFERENCES: To ensure that the IRS designs its Current and Future State initiatives based on actual taxpayer needs and preferences, the IRS must actively and directly engage with the taxpayer populations it serves as well as undertake a robust research agenda that furthers an understanding of taxpayer compliance.**

In 2005, Congress directed the IRS to conduct a comprehensive review of its current portfolio of services and develop a five-year strategic plan for taxpayer service.<sup>55</sup> That plan, the Taxpayer Assistance Blueprint (TAB), has since been updated annually, by congressional directive.<sup>56</sup> Far from being a strategic plan, the TAB has deteriorated into a list of unrelated initiatives. Meanwhile, IRS budget cuts and consequent elimination or radical restructuring of core taxpayer services have increased taxpayer burden and cost.

An understanding of taxpayer needs and preferences is a prerequisite for effective tax administration.<sup>57</sup> As Figure S.2 shows, the IRS and TAS have separately undertaken different surveys attempting to identify taxpayer needs. The way one asks questions on the surveys, and the very method of conducting the survey, has consequences for the reliability and usefulness of the data collected. For example, a recent Pew Research Center analysis of survey techniques concluded that online-only surveys have a bias against African-Americans and Hispanics.<sup>58</sup>

55 H. REP. NO. 109-307, at 209 (2005).

56 See S. REP. NO. 113-80, at 27 (2013); see also IRS Pub. 4701, *Annual Report to Congress: The Taxpayer Assistance Blueprint Taxpayer Service Improvements* (Nov. 2015), <http://core.publish.no.irs.gov/pubs/pdf/p4701-2015-11-00.pdf>.

57 See Statement of Leslie Book, Professor, Villanova School of Law, National Taxpayer Advocate Public Forum 27 (Feb. 23, 2016): I think a fundamental starting point in thinking about service is that the IRS needs to know whom it is serving and the characteristics and challenges associated with a particular group of taxpayers or parties it is regulating. It sounds easy enough but knowing the taxpayer actually is a very resource intensive endeavor. An agency fixated on efficiency and delivering services at lowest possible short term costs without knowing the impact and burdens of its actions may find itself pushing more serious problems down the road while at the same time jeopardizing taxpayer rights.

58 Pew Research Center, *Evaluating Online Nonprobability Surveys: Vendor Choice Matters; Widespread Errors Found for Estimates Based on Blacks and Hispanics* (May 2, 2016), <http://www.pewresearch.org/2016/05/02/evaluating-online-nonprobability-surveys/>. “Online nonprobability survey vendors want to provide samples that are representative of the diversity of the U.S. population, but one important question is whether the panelists who are members of racial and ethnic minority groups are representative of these groups more broadly. This study suggests they are not.” *Id.* at 4.

FIGURE S.2, Summary of Taxpayer Surveys

| Survey   | Description/Purpose   | Methodology  | Sample Size  | Data Collection Frequency | Survey Conducted |
|--|---|--|--|---------------------------|------------------|
| Low Income Taxpayer Clinic Survey              | <p>The Low Income Taxpayer Clinic (LITC) Program provides tax representation or advice to low income individuals who need help resolving issues with their federal income tax returns.</p> <p>TAS multi-purpose study to learn more about taxpayers who are eligible for help from LITCs. The study gathered information on:</p> <ul style="list-style-type: none"> <li>• eligible taxpayers' awareness and use of LITC services,</li> <li>• the types of issues for which they would consider using clinics,</li> <li>• demographic information, and</li> <li>• other items.</li> </ul> <p>Findings are representative of the low income population (household income at or below 250% of the poverty level), including Spanish speakers of this population.</p> | Telephone Random Digit Dialed (RDD) landline and cellphone | 1,143<br>934 English<br>204 Spanish  | One time                  | 2014             |
| The Taxpayer Advocate Service: Hispanic Survey | <p>TAS Multi-purpose study to evaluate taxpayer knowledge, beliefs, barriers and perception of TAS and the IRS among US Hispanics.</p>  | Telephone Random Digit Dialed (RDD) landline and cellphone | 1,014 US General Population<br>Hispanics ages 18 and older<br>432 English<br>582 Spanish | One time                  | 2014             |
| Service Priorities Survey                      | <p>TAS Multi-purpose taxpayer survey to explore:</p> <ul style="list-style-type: none"> <li>• Taxpayers' use of IRS services by delivery channels, as well as service users satisfaction and issue resolution with services, as well as willingness to use and importance of delivery channels;</li> <li>• Taxpayers' understanding of their rights and responsibilities with IRS</li> <li>• Internet use and abilities</li> </ul>  | Telephone Random Digit Dialed (RDD) landline and cellphone | 4,000<br>By mid-November, 1,910 completed<br>1,106 landline, 804 cell phone              | Depends on funding        | 2016             |
| Taxpayer Experience Survey                     | <p>Multi-purpose taxpayer survey to explore:</p> <ul style="list-style-type: none"> <li>• Taxpayers' awareness and use of IRS services and service channels, as well as service users satisfaction with services;</li> <li>• Taxpayers' behavior patterns and potential areas for improvements based on their pre-filing, filing, and post-filing experiences (includes experience with refunds &amp; notices); and</li> <li>• Knowledge of ACA requirements.</li> </ul>  | Online Panel / Phone                                       | 3,689<br>(2,986 online English;<br>403 online Spanish;<br>300 Phone English)             | Annually                  | 2016             |

Table continued on next page. ►



FIGURE S.2, Summary of Taxpayer Surveys (continued)

| Survey  | Description/Purpose   | Methodology   | Sample Size                          | Data Collection Frequency   | Survey Conducted                    |
|---|---|---|--------------------------------------|---|-------------------------------------|
| <b>TAC Expectations Survey</b>  | Survey of TAC users designed to capture TAC customer demographic profile, measure overall and service delivery satisfaction, and the extent to which TAC customer service and performance expectations were met from the taxpayer perspective. Data from this research endeavor helps Field Assistance assess and modify its business model.  | Paper / In-person<br>Used cluster analysis to categorize TACs. 3 visits (pre-filing, filing, post-filing) to each of the 5 different TAC types for a total of 15 visits:<br><ul style="list-style-type: none"> <li>• High volume, High wait; Medium Volume, High Overhead;</li> <li>• Medium volume, Low overhead;</li> <li>• Low Volume, Less complex; and</li> <li>• Low Volume, Complex Task.</li> </ul> | 1,519 in FY 2013                     | Every three years   | FY 2013 completed, 2016 in analysis |
| <b>Web - First Strategy Conjoint</b>  | Conjoint survey aimed at understanding how taxpayers' preferences shift with changes to service offerings. This conjoint survey offers participants different scenarios for services, with tradeoffs to see which options are the most important to participants. The study objectives are to: <ul style="list-style-type: none"> <li>• Determine the effect of potential service changes on preference for TAC and phone.</li> <li>• Assess baseline preferences for online services and identify potential methods for increasing preference for online services.</li> <li>• Explore how potential service changes, including the addition of new online service options, affect taxpayer preference for higher cost channels, such as TAC and phone.</li> <li>• Suggest how the IRS can facilitate a preference shift to web-first service options.</li> </ul> | Online Panel  | 1,604                                | Every year or two depending on funding  | 2015 - 2016                         |
| <b>IRS Oversight Board - Comprehensive Taxpayer Attitude Survey (CTAS) 2015</b> | Telephone survey which captures taxpayers' tax compliance attitudes, service channel preference, and behaviors (can be compared to findings from previous surveys)  | Random Digit Dialed Telephone - landline and cell phone   | 1,000 - 707 landline, 293 cell phone | Annually. Survey may be discontinued given the uncertain status of the IRS Oversight Board. | 2015                                |

The IRS has heavily relied upon the Web-First Strategy Conjoint Survey to build its online account. That survey, conducted fully online, is helpful in understanding what taxpayers who are *already online* are willing to do with regard to *online tax administration*. But the survey ignores those taxpayers who are not online or who are unwilling to participate in online surveys.<sup>59</sup>

During the last year, TAS has conducted a survey by telephone (landline and cellphone) of U.S. taxpayers, including those taxpayers who have used IRS service channels in the recent past.<sup>60</sup> Although our analysis is preliminary, TAS is able to report results on particular segments of the individual taxpayer population, including:

- Not Low Income taxpayers (taxpayers with total positive income (TPI) above 250 percent of the federal poverty level);<sup>61</sup>
- Low Income taxpayers (taxpayers TPI at or below 250 percent of the federal poverty level);
- Elderly taxpayers (taxpayers age 65 or older); and
- Disabled taxpayers (taxpayers who self-identified as having a significant disability).

The survey findings for these categories of taxpayers, reported below, are statistically representative of all taxpayers in these categories.<sup>62</sup> The importance of the responses of the low income taxpayer population is particularly significant, since these taxpayers constitute over 46 percent of the individual taxpayers filing returns in 2016.<sup>63</sup> TAS conducted this survey entirely by telephone (landline and mobile phone) in order to ensure it was not biased against taxpayers who were not online or unwilling to answer surveys online.

The study found that Low Income, Senior, and Disabled taxpayers are less likely to have broadband access and more likely to have no internet access than the Not Low Income taxpayers. More than 33 million U.S. taxpayers have no broadband access at home, including 14 million U.S. taxpayers who have no internet access at home. Notably, 28.5 percent, 40 percent, and 31.9 percent of the Low Income, Senior, and Disabled taxpayers, respectively, had no broadband access at home, significantly limiting their online activities.

59 For a more detailed discussion of our concerns about the IRS online account, see *Most Serious Problem: Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*, *infra*. See also *Literature Review: Customer Considerations for Online Accounts Introduction*, vol. 3, *infra*.

60 See *Research Study: Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

61 Total Positive Income (TPI) is calculated by summing the positive values from the following income fields from a taxpayer's most recently filed individual tax return: wages; interest; dividends; distribution from partnerships, small business corporations, estates, or trusts; Schedule C net profits; Schedule F net profits; and other income such as Schedule D profits and capital gains distributions. Losses reported for any of these values are treated as zero.

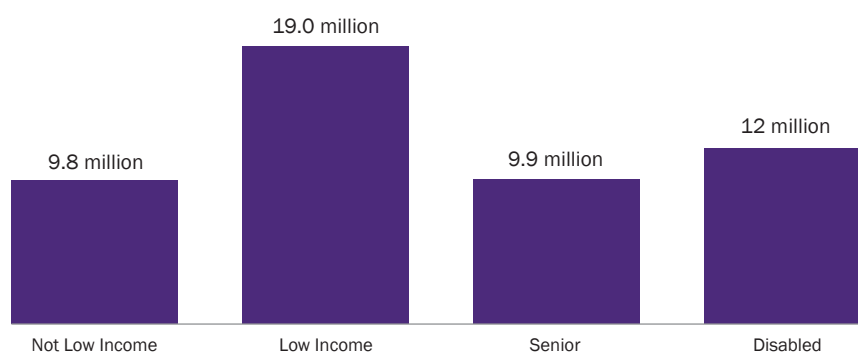
62 For this interim analysis, the confidence interval ranges from +/- 3 percent to 10 percent, depending on the sample size for each question, with most questions falling into the +/- range of 5 percent or better. TAS Research expects confidence levels to improve upon receipt of the complete data set of 4,000 surveys. For a more detailed discussion of the survey design and methodology, see *Research Study: Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

63 Of the 135.8 million individual taxpayers who had filed TY 2015 individual income tax returns through Cycle 43 of 2016, nearly 63 million taxpayers (46.2 percent) had TPI at or below 250 percent of federal poverty level. These numbers exclude filers who are claimed as a dependent on another tax return. Individual Returns Transaction File for Tax Year 2015 (returns processed through October 31, 2016) on the IRS Compliance Data Warehouse.

The IRS has heavily relied upon the Web-First Strategy Conjoint Survey to build its online account. That survey, conducted fully online, is helpful in understanding what taxpayers who are *already online* are willing to do with regard to *online tax administration*. But the survey ignores those taxpayers who are not online or who are unwilling to participate in online surveys.

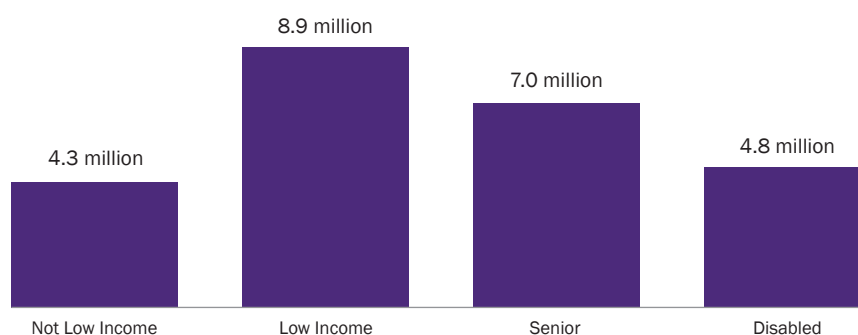
**FIGURE S.3**<sup>64</sup>

**Taxpayers Without Broadband Access at Home by Demographic Group**



**FIGURE S.4**<sup>65</sup>

**Taxpayers Without Internet Access at Home by Demographic Group**



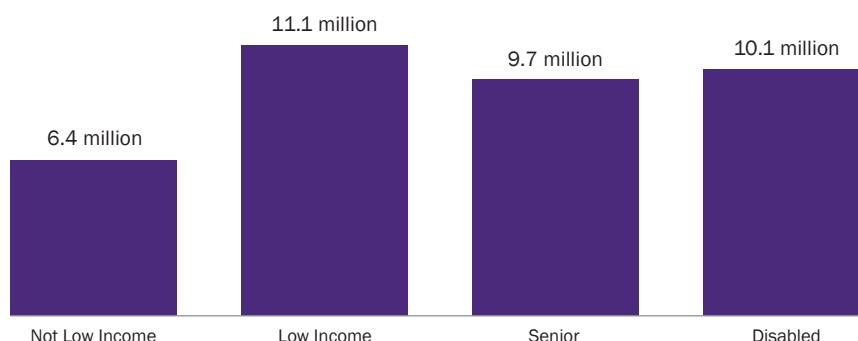
64 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

65 *Id.*

The Not Low Income taxpayer group is online more frequently (from home, work, or elsewhere) than the vulnerable groups. Almost 19 percent of the combined Low Income, Senior, and Disabled taxpayer populations said they go online less than once a week or never.

**FIGURE S.5**<sup>66</sup>

**Taxpayers Who Access the Internet Less Than Once a Week, or Not at All, by Demographic Group**



Low Income Taxpayers are more likely than Not Low Income taxpayers to access the internet from libraries or through their smartphones.<sup>67</sup> Access to IRS online accounts via public computers can create serious risks to the privacy of taxpayer data. Moreover, taxpayers whose internet access is through their smartphones report being seriously disadvantaged in performing tasks like uploading resumes and filling out online job applications.<sup>68</sup> Other complex tasks such as filing a tax return may also pose similar challenges. These findings have significant consequences for a large part of the taxpayer population as the IRS shifts to online accounts, audits, and communication.

The IRS has published several “vignettes” that depict how different types of taxpayers will interact online with the IRS of the future.<sup>69</sup> Both the Individual (EITC) taxpayer and the Small Business taxpayer vignettes contemplate in-home or in-work broadband access and taxpayers who are comfortable with online tasks. The TAS survey findings show that for large portions of the taxpayer population, taxpayers continue to be uncomfortable with many aspects of online interaction. For example, all of the vulnerable groups (Low Income, Elderly, and Disabled) are less comfortable sending emails on the internet than the Not Low Income. Similarly, all of the vulnerable groups, particularly Seniors, feel they are less

66 See Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

67 For underlying data, see *id*.

68 Written Statement of Aaron Smith, Pew Research Center, National Taxpayer Advocate Public Forum 1-2 (Feb. 23, 2016): In a recent survey that we conducted about job seeking online, for example, these “smartphone only” users were far more likely than other Americans to have used their smartphone for highly complex tasks, such as filling out a job application or even creating a resume or cover letter. And in general, a substantial number of non-broadband adopters indicate that performing even relatively basic online job-seeking activities — such as emailing an employer, or filling out an online application — can be challenging without the benefit of a dedicated home connection.”

69 See <https://taxpayeradvocate.irs.gov/public-forums> and <https://www.irs.gov/uac/newsroom/future-state-and-irs-activities>. For a detailed discussion of the flawed assumptions relating to the Individual (EITC) vignette, see *Most Serious Problem: Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

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**More than 33 million U.S. taxpayers have no broadband access at home, including 14 million U.S. taxpayers who have no internet access at home. Notably, 28.5 percent, 40 percent, and 31.9 percent of the Low Income, Senior, and Disabled taxpayers, respectively, had no broadband access at home, significantly limiting their online activities.**

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skilled than the Not Low Income at doing research on the internet. And most importantly, more than half of the Low Income, Senior, and Disabled taxpayers stated they did not feel secure sharing personal financial information over the Internet. Indeed, even among the Not Low Income population, over 43 percent of taxpayers said they do not feel secure sharing their personal financial information over the Internet.

Finally, significant percentages of all taxpayer segments did not feel secure sharing personal information with a government agency. Only 38 percent of the Not Low Income population, 33 percent of the Low Income, 17 percent of the Seniors, and 32 percent of Disabled taxpayers were comfortable sharing personal information with the government. These findings have profound implications for taxpayers' willingness to interact with the IRS online in all but the most rudimentary of actions.

These survey findings were mirrored in testimony and comments made at the National Taxpayer Advocate's Public Forums on Taxpayer Needs and Preferences, as well as the Focus Groups at IRS Tax Forums and TAS employee meetings.<sup>70</sup> From all the data and public suggestions, it is clear that an inadequate emphasis on and provision of in-person assistance will harm U.S. taxpayers in the 21st century.

### Recommendations

To ensure that both the present and future states of the IRS serve taxpayers well, the National Taxpayer Advocate recommends that:

- The IRS, in collaboration with the National Taxpayer Advocate, undertake a comprehensive study of taxpayer needs and preferences by taxpayer segment, utilizing telephone, online, and mail surveys, focus groups, town halls, public forums, and research studies. These initiatives should be designed to solicit *taxpayer* needs and preferences, and not be biased by the IRS's own desired direction.
- Congress require the IRS and the National Taxpayer Advocate to jointly report on the results of this comprehensive study through a re-invigorated TAB.

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<sup>70</sup> See, e.g., Oral Statement of Susan Diehl, PenServ Plan Services, Inc., National Taxpayer Advocate Public Forum 18 (Apr. 8, 2016):

What I have observed is that the new individual and business taxpayer experience of the future model seemed to provide little room for personal contact. Granted, this will fit well into the constraints of the budget, but I fear that many will suffer and suffer greatly. Let's consider retirees who have extremely involved questions. Who will help them? Will this model result in more unanswered phone calls with no resolution, or a resolution that comes too late leaving the taxpayer in a penalty situation.

See also Taxpayer Advocate Service, *Executive Briefing: Future State Discussion Analysis* 18 (Sept. 2016):

The IRS will be faceless. A taxpayer's only interactions with a human at the IRS will be when there is an enforcement-type action taken with regard to the taxpayer's account. It will leave many taxpayers without basic services needed to comply with the tax system. On one hand, the described scenario might decrease calls and staffing during the initial processing but it could very easily increase calls and staffing after processing because the taxpayer requires clarification of changes and adjustment to his/her account. We have experienced numerous calls when the bar on the "Where's my refund" application changes unexpectedly.

## TAXPAYER RIGHTS AND THE FUTURE STATE

Since adopting the National Taxpayer Advocate's proposed Taxpayer Bill of Rights (TBOR), the IRS has made commendable efforts to inform taxpayers about their rights.<sup>71</sup> As we observe later in this report, however, the IRS has a more uneven record in complying with the congressional mandate, codified in Internal Revenue Code (IRC) § 7803(a)(3), to educate IRS employees about the TBOR.<sup>72</sup>

The National Taxpayer Advocate believes that taxpayer rights, and the TBOR specifically, should be the foundation for tax administration, including any strategic vision for the future. Yet few documents pertaining to the Future State that have been made available to the National Taxpayer Advocate address the TBOR, and those that do only nominally mention it, utilizing a checklist approach at best. None explains how the proposed Future State design and initiatives will specifically advance the general rights stated in the TBOR and the specific protections afforded by the IRC.<sup>73</sup>

At each of the National Taxpayer Advocate's Public Forums on Taxpayer Needs and Preferences, the panelists and audience members were provided copies of IRS Future State "vignettes" pertaining to individual and small business taxpayers.<sup>74</sup> These vignettes provide the most detailed representation of the Future State made public to date. As such, they offer insight into how the IRS thinks it will interact with the taxpayers of the future.

At every Public Forum, panelists and audience members expressed serious concerns about the interactions described in the vignettes. A threshold concern was that the system the IRS is designing seems to be stacked in the IRS's favor — *i.e.*, in both vignettes, the taxpayer lost; he or she was wrong. Nowhere did the vignette demonstrate how the taxpayer could prevail in the system of the future. Public Forum panelists and audience members alike commented on this aspect of the Future State:

*I find it funny that* in both scenarios, there's more taxes. I think that reflects the idea that this model is about the IRS finding new ways to use technology for their benefit, and not for taxpayer purposes.<sup>75</sup>

*I'm a CPA*, and I've been practicing for 35 years, but my primary reason for coming here, at least — I read your year-end report, and even just seeing these future state diagrams here, and what struck me is there's an arrogance unfortunately of the IRS that they can do this themselves, and they don't need any input from taxpayers. And the examples here — both end up resolving in more tax being owed, is like, we were right, you were wrong, pay us the money.<sup>76</sup>

71 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

72 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)). For a detailed discussion of the IRS's TBOR efforts, see Most Serious Problem: *Taxpayer Bill of Rights (TBOR): The IRS Must Do More to Incorporate the TBOR into Its Operations*, *infra*.

73 The National Taxpayer Advocate has identified specific taxpayer rights concerns relating to "Real Time" tax administration before. See National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-295 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

74 <https://taxpayeradvocate.irs.gov/public-forums>. For a reproduction and discussion of the EITC vignette, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

75 Statement of Audience Member, National Taxpayer Advocate Public Forum 39 (Aug. 18, 2016).

76 Statement of Audience Member, National Taxpayer Advocate Public Forum 55-56 (Aug. 18, 2016).

Other panelists noted that the basic assumptions about the taxpayer population illustrated in the vignettes were seriously flawed.<sup>77</sup> For example, the vignette for individual taxpayers involved an EITC claimant, and as we discuss in a Most Serious Problem later in this report, it assumes that the average EITC recipient has broadband access and a desktop computer in her home, has a high enough education level to hold a middle-school math teacher job, has a sufficient credit history to create an IRS online account, and can navigate and understand the complex provisions of the tax code.<sup>78</sup> None of these assumptions is accurate with respect to the average EITC recipient. For example, in eight of the 11 cities in which the National Taxpayer Advocate held Public Forums, the starting salary of a middle school math teacher is above the EITC income eligibility for a two-person household. In essence, the entire vignette is based on a nonexistent taxpayer profile. Yet this has not stopped the IRS from building its vision upon this illusion or, at a minimum from using this grossly inaccurate profile to illustrate its vision.

Moreover, the IRS Future State vignettes seem to envision a completely digital interaction with taxpayers about intensely factual and specific matters. Participants in every Public Forum, every Tax Forum focus group, and every TAS group meeting felt this vision was unrealistic and harmful to taxpayers.<sup>79</sup> Here are just a few of the statements from Public Forum participants.

*Because real life situations of real people* are so unique that you couldn't make them up, you know, they just — the way that people come to us and with their circumstances, you go, Oh my God how did this happen, but this is the way it is and you have to deal with it. And you're helping them. We couldn't even imagine it.

And again, it's just very arrogant of any computer person who decided to design and think that that's all the options that there are. There's always — you have to be able to think outside the box. That's where a live human being will always be better.<sup>80</sup>

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*The future vision of the IRS* assumes that taxpayers have access to technology and will be able to navigate the IRS's online system to resolve their tax issues. We know from representing vulnerable populations, such as the poor, disabled and elderly, in dealing with our current tax system that they will have no easier time navigating some new online system. There will still be barriers created by poor literacy, mental and physical impairments in the complicated nature of our tax system, as well as new ones, such as access to technology and understanding how to use it. Given this, the IRS's future state vision could make the tax issues of low income and otherwise vulnerable taxpayers worse if they use the online system without fully appreciating what they are agreeing to and what rights they may be foregoing.

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77 See Oral Statement of Polly Bone, Texas RioGrande Legal Aid, Inc., National Taxpayer Advocate Public Forum 54-55 (Aug. 30, 2016):

First of all, this vignette, I'm wondering why whoever wrote it may think this is hardly representative of the people who get the earned income tax credit. ... I looked up the starting salaries of teachers here in SAISD and with what, one child her full year, she would not qualify for an earned income tax credit ... . So this isn't representative at all. My client would more than likely be someone who would be a provider or a health home provider, something that goes in and takes care of elderly people during the day or someone who works in housekeeping at one of our many hotels here in San Antonio.

78 See Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

79 <https://taxpayeradvocate.irs.gov/public-forums>.

80 Statement of Audience Member, National Taxpayer Advocate Public Forum 57-58 (Aug. 18, 2016).



In addition, given the issues the IRS has in replying to mail, I do not have much confidence that electronic communications will be acted upon in a timely manner either.<sup>81</sup>

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***Our first choice of action***, typically, if it is fairly straightforward we can compare numbers and see, okay, yeah, there was a mistake, something was missing. We didn't have certain information. Whatever it might be. We could probably handle that by correspondence. Write a check or write a letter. We will get it resolved. A lot of times we need to get on the phone.

So one concern that I have, I think our office has in general with the future state is really looking towards heavy reliance on electronics, technology, to be able to tell us the information that we need. Our experience has been that tells us half the story. It tells us what the IRS thinks is going on or what's in their system that might be causing a problem. But it doesn't actually resolve everything. We have had access to online services in the past, and it gives us some information about what is going on, why the IRS is sending this notice, what might have triggered it, that we can maybe troubleshoot and figure out here is what is missing, or here's what they don't have. But the rest of the story typically takes a phone call.<sup>82</sup>

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***And again, because people need back tax help***, they need to get copies of their transcripts. In looking at the different ways that the IRS is considering how to get transcripts, I think if you're there on a Tuesday online, the moon is waxing and, you know, there's like a gerbil in the room, you qualify. I think it's like a very narrow set of people that are going to be able to use that.<sup>83</sup>

### ***Digital Communications and the "Mailbox Rule"***

Underlying these general concerns is the potential for erosion of very specific taxpayer rights. For example, under IRC § 7502, if a taxpayer can demonstrate he has mailed a particular document to the IRS on or before the statutory due date, it will be deemed to be timely filed. The Secretary is authorized to promulgate regulations setting forth how "*prima facie* evidence of delivery and the postmark date shall apply to certified mail and electronic filing."<sup>84</sup> This rule is known as the "timely mailed, timely filed" or "mailbox" rule. To date, the IRS has not explained how this rule will be applied in the Future State.

For example, let's look at Jane, the EITC taxpayer described in the IRS's vignette. Suppose Jane receives a math error notice under IRC § 6213 giving her 60 days to request abatement of the tax and receive deficiency procedures. On day 60, Jane logs on to her IRS account and sends an email requesting an abatement. The IRS receives the email on day 61. In discussions with the Office of Chief Counsel, the National Taxpayer Advocate has been advised that the mailbox rule would not apply to this email, and thus Jane did not respond timely, the assessment stands, and she loses her right to deficiency procedures. This means she also loses the opportunity to petition the United States Tax Court, the only judicial

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81 Written Statement of Arthur Bartlett, Legal Services of Southern Piedmont, National Taxpayer Advocate Public Forum 20-21 (Apr. 4, 2016).

82 Oral Statement of Rollin J. Groseclose, Johnson Price Sprinkle, National Taxpayer Advocate Public Forum 25-26 (Apr. 4, 2016).

83 Oral Statement of Robin McKinney, Maryland CASH Campaign, National Taxpayer Advocate Public Forum 44 (May 13, 2016).

84 IRC § 7502(c)(2).



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**For the Future State to succeed, the IRS and Congress should consider how the mailbox rule will apply to digital communications, weighing the alternatives in the light most favorable to the taxpayer.**

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forum in which a taxpayer can challenge a deficiency without paying the tax first, undermining her *right to appeal an IRS decision to an independent forum*. When the National Taxpayer Advocate pointed out that the taxpayer could prove when the email was sent (just as a facsimile log can show when a fax transmission occurred), representatives of the Office of Chief Counsel stated that emails and facsimile dates can be altered by the taxpayer, just as postage meter dates can be altered, and therefore the mailbox rule should not apply to digital communications. Under this approach, only the unsophisticated will utilize digital communications where the date of a document is critical.

Here, then, we have the heart of the problem with the Future State. It is designed around a fundamental suspicion that all taxpayers are likely to cheat, rather than giving taxpayers the benefit of the doubt and assuming they will not manipulate dates. If we really care about taxpayer rights, including the right to appeal to an independent forum, we should design a system that is based on the premise that most taxpayers are willing and trying to comply with the tax laws. For the Future State to succeed, the IRS and Congress should consider how the mailbox rule will apply to digital communications, weighing the alternatives in the light most favorable to the taxpayer.

### *What's an Audit? Taxpayer Rights and Real-Time Adjustments During the Filing Season*

An even more troubling issue arises when we consider the impact of the IRS's increasing ability to identify errors and questionable returns while a return is being processed and before a refund is issued. In general, the accelerated due date for Forms W-2 and 1099-Misc (used to report non-employee compensation)<sup>85</sup> is an extremely important and positive development, one that the National Taxpayer Advocate has proposed since 2009.<sup>86</sup> But shifting examinations of returns into the filing season has profound implications for taxpayer rights that the IRS has neither acknowledged nor addressed. For example, there is a question about what rights accrue during income-matching and other pre-refund "reviews" of returns.

The National Taxpayer Advocate has previously written about "real" versus "unreal" audits. IRC § 7602(a)(1) grants the IRS the authority to examine any books, papers, records, or other data that may be relevant to ascertain the correctness of any return. The IRS interprets this provision narrowly; thus Automated Underreporter (AUR), Automated Substitute for Return (ASFR), Substitute for Return (SFR), and math and clerical error assessments, along with the entire category of questionable refund and return procedures are not classified as "real" audits.<sup>87</sup> As Figure S.6 shows, this classification system results in the majority of taxpayer compliance contacts being "unreal" audits — far outstripping what the IRS classifies as "audits" and the National Taxpayer Advocate calls "real" audits.<sup>88</sup>

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85 Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015).

86 See National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*); see also National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

87 An attempt to resolve a discrepancy between a taxpayer's return and third party data does not constitute an examination because the IRS "merely" is asking the taxpayer to explain the discrepancy. Rev. Proc. 2005-32, § 4.03, 2005-1 C.B. (2006).

88 See, Nina Olson, *What's an audit, anyway?*, NATIONAL TAXPAYER ADVOCATE BLOG (Jan. 25, 2012), <https://taxpayeradvocate.irs.gov/news/what's-an-audit-anyway>.

**FIGURE S.6, Real vs. Unreal Audits: FY 2015 Occurrences Relating to Returns Filed for Tax Year 2014<sup>89</sup>**

| Adjusted Gross Income Category    | FY 2015 Exams  | Exam Coverage % | FY 2015 ASFR   | FY 2015 AUR      | FY 2015 Math Error | FY 2015 Combined | Returns Filed in Calendar Year 2014 | Combined Coverage % |
|-----------------------------------|----------------|-----------------|----------------|------------------|--------------------|------------------|-------------------------------------|---------------------|
| No adjusted gross income          | 20,263         | 1%              | 184,776        | 12,544           | 31,329             | 248,448          | 2,401,182                           | 10%                 |
| \$1 under \$25,000                | 427,452        | 1%              |                | 930,554          | 708,164            | 2,052,646        | 54,757,719                          | 4%                  |
| \$25,000 under \$50,000           | 150,191        | 0%              |                | 1,101,847        | 479,513            | 1,717,095        | 34,032,631                          | 5%                  |
| \$50,000 under \$75,000           | 65,710         | 0%              |                | 557,679          | 283,301            | 897,614          | 19,418,889                          | 5%                  |
| \$75,000 under \$100,000          | 56,460         | 0%              |                | 351,880          | 178,036            | 580,175          | 12,574,091                          | 5%                  |
| <b>Subtotal - under \$100,000</b> | <b>720,076</b> | <b>1%</b>       | <b>184,776</b> | <b>2,954,504</b> | <b>1,680,343</b>   | <b>5,495,978</b> | <b>123,184,512</b>                  | <b>4%</b>           |
| \$100,000 under \$200,000         | 98,403         | 1%              |                | 600,769          | 232,752            | 921,406          | 17,349,237                          | 5%                  |
| \$200,000 under \$500,000         | 59,395         | 1%              |                | 210,091          | 47,287             | 313,689          | 5,020,982                           | 6%                  |
| \$500,000 under \$1,000,000       | 18,149         | 2%              |                | 34,040           | 6,339              | 58,030           | 808,547                             | 7%                  |
| \$1,000,000 under \$5,000,000     | 14,657         | 4%              |                | 12,546           | 2,861              | 29,769           | 370,989                             | 8%                  |
| \$5,000,000 under \$10,000,000    | 2,174          | 8%              |                | 658              | 261                | 3,060            | 26,559                              | 12%                 |
| \$10,000,000 or more              | 3,529          | 21%             |                | 335              | 288                | 4,055            | 16,797                              | 25%                 |
| <b>Total</b>                      | <b>916,383</b> | <b>0.6%</b>     | <b>184,776</b> | <b>3,812,943</b> | <b>1,970,131</b>   | <b>6,825,987</b> | <b>146,777,623</b>                  | <b>4.7%</b>         |

<sup>89</sup> Data from Individual Returns Transaction File, Individual Master File, and Notice Delivery System from the Compliance Data Warehouse. The audits represent taxpayers where the IRS posted a transaction code 420 to at least one individual taxpayer account in FY 2015. In some cases, the return was accepted as filed prior the IRS contact. The statistics for returns secured through Automated Substitute for Return (ASFR) are from the IRS FY 2015 Collection Activity Report No. 5000-139. Since ASFR returns are not filed by the taxpayer, no adjusted gross income (AGI) is associated with the return. The number of taxpayers receiving an Automated Underreporter (AUR) contact are those who received a CP 2000 or CP 2501 notice from the IRS in FY 2015. The combined coverage rate removes duplicates, so that a taxpayer is only counted once even if affected by two or more of these compliance programs in FY 2015. Taxpayers who received FY 2015 compliance actions on tax returns in more than one AGI category are counted in each AGI category. The coverage rate is computed by dividing by the number of individual income tax returns filed in each AGI category for Tax Year 2014.

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At every Public Forum, panelists and audience members expressed serious concerns about the interactions described in the vignettes. A threshold concern was that the system the IRS is designing seems to be stacked in the IRS's favor — *i.e.*, in both vignettes, the taxpayer lost; he or she was wrong. Nowhere did the vignette demonstrate how the taxpayer could prevail in the system of the future.

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The National Taxpayer Advocate's position is that for purposes of IRC § 7602, an audit includes both pre-refund and post-refund examinations of returns that require the taxpayer to provide some level of documentation. This definition has several consequences relating to the taxpayer's *right to finality* and the *right to appeal an IRS decision in an independent forum*. First, it more accurately states the audit rate, which will be higher than what the IRS currently reports, and it changes the incidence of the audit rate. Second, and more importantly, it protects taxpayers from multiple reviews of the same return — it forces the IRS to identify *all* issues relating to the return that require some sort of documentation and address those issues as early as possible in one proceeding.<sup>90</sup> Third, and most importantly, it provides the taxpayer with an appeal to the IRS Office of Appeals. Currently, when a taxpayer disagrees with an “unreal” audit's proposed assessment, the taxpayer receives a Statutory Notice of Deficiency, with no opportunity to seek an administrative appeal to the IRS Office of Appeals. The taxpayer's only option is to go to the U.S. Tax Court, the cost of which may be prohibitive for many taxpayers. In “real” audits, on the other hand, taxpayers generally receive 30-day letters offering them a chance to request an administrative appeal before petitioning the Tax Court.

### *Effect of Erroneous IRS Advice Communicated Digitally*

The reliance on online “communications” and “digital notifications” raises the question of whether such communication constitutes erroneous written advice for purposes of interest abatement. IRC § 6404(f)(1) requires the IRS to abate penalties and additions to tax attributable to deficiencies where a taxpayer relied on erroneous written advice from the IRS. The IRS's vision of its Future State, and its current Taxpayer Digital Communication pilot, utilize the online account and secure emails to exchange information, including answers to taxpayer questions. If the IRS provides a “tailored digital communication,” as it does in the vignette about Bennett, the Small Business taxpayer, is that “written advice” under IRC § 6404(f)? Moving people from the phones (oral advice) to emails and other digital communications increases the IRS cost of inaccuracy, because failure to be accurate will cost the public fisc through interest abatements. In the past, the IRS has responded to risks like this by minimizing and dumbing down the specific advice it provides to taxpayers, as it has in the case of declaring entire areas of tax law “out of scope” for purposes of telephone tax law assistance. Thus, by moving to a digital format, the IRS may be reducing the assistance it provides to taxpayers, and this will increase their costs of tax compliance by driving them to tax preparers who charge a fee. Receiving overly broad or unreliable “digital notifications” is not a desirable Future State.

These issues are not new, and they are only the most obvious examples. They were first raised in 2011, both at the public hearing held by the IRS on Real Time Tax Administration,<sup>91</sup> and in the National

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90 IRC § 7605(b) protects taxpayers from unnecessary examinations and inspections and generally allows the Secretary to conduct only one inspection of a taxpayer's books of account for each taxable year.

91 Comments of T. Keith Fogg, Director, Villanova Law School Federal Tax Clinic, Real Time Tax System Initiative (Dec. 8, 2011), [http://www.irs.gov/pub/irs-utl/t.\\_keith\\_fogg\\_aba\\_tax\\_section\\_and\\_low\\_income\\_tax\\_clinic.pdf](http://www.irs.gov/pub/irs-utl/t._keith_fogg_aba_tax_section_and_low_income_tax_clinic.pdf) (last visited Aug. 2, 2012).

Taxpayer Advocate's 2011 and 2012 Reports to Congress.<sup>92</sup> In numerous meetings of the IRS senior leadership and Future State teams, the National Taxpayer Advocate has asked the IRS and the Office of Chief Counsel to articulate its position and explain to the public how it will protect taxpayers from repetitive audits in the Future State. To date, neither the IRS nor the Office of Chief Counsel has provided any response. To design a Future State without addressing these and related concerns means that the Future State is not based on taxpayer rights, and taxpayer rights will be layered on as an afterthought rather than serving as a foundation for the future of tax administration.

### Recommendation

The National Taxpayer Advocate recommends that the Office of Chief Counsel, in collaboration with the National Taxpayer Advocate, immediately undertake a comprehensive review of key taxpayer rights provisions in the IRC and issue proposed guidance for public comment, updating these provisions to protect taxpayer rights in the digital environment envisioned by the IRS Future State. These provisions include the application of the mailbox rule and the erroneous advice rule to digital communications, and the definition of an “examination” or “audit” in light of the substantial pre-refund review activity envisioned by the Future State.

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92 National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

**GROSSLY OUTDATED TECHNOLOGY AND INFRASTRUCTURE: To enable the IRS to meet the major technology improvements required for a 21st century tax administration even as it fulfills current operational technology demands, the IRS must articulate a clear strategy that will reassure Congress and taxpayers the funding will be well-spent.**

The current state of the IRS's technology limits how much and how quickly the IRS can advance to its "Future State." But the impact of technology on *today's* tax administration cannot be overstated. As we discuss later in a Most Serious Problem on Enterprise Case Management,<sup>93</sup> the IRS has two of the oldest information systems in the federal government.<sup>94</sup> Think about that — the nation's revenue accounts are accessed and stored on five-decade old technology.

Today, the IRS has at least 60 major case management systems, and estimates range anywhere from 60 to 200 repositories of case data. This means that when a taxpayer calls the IRS for information about his or her account, the employee on the phone often doesn't have access to the relevant system, can't answer the taxpayer's question, and has to send a referral to another IRS function to handle (one that has access to the relevant system). This all but certainly leads to the taxpayer calling or writing again, creating a vicious cycle of ever more work for the IRS and the taxpayer.

In the National Taxpayer Advocate's Public Forums, taxpayers and practitioners alike spoke with enthusiasm about how an online account could provide them basic information without having to wait endlessly on the telephone. But the IRS's ability to provide the full and seamless experience taxpayers and representatives want is far from a reality. For example, taxpayer representatives were particularly eager to see copies of notices that had been sent to their clients, since many clients don't retain them or misplace them.<sup>95</sup> Yet most IRS notices are "vapor" — they don't exist on IRS systems except as a record that such-and-such notice number was sent. Moreover, most letters and correspondence the IRS sends to taxpayers in audits and collection are not retained on IRS systems as digital images. Even if they were, the IRS would have to program between all of its case management systems and the online account in order for the information to be uploaded into the account. This is years away, and in the meantime, taxpayers and their representatives will continue to call and write.

In the Public Forums, the Nationwide Tax Forum focus groups, and the TAS group meetings, all participants expressed concern about the security of an online account.<sup>96</sup> The IRS shares those concerns and has been consulting with both government and private sector experts on this matter. The IRS cannot

93 See Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

94 Government Accountability Office (GAO), GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS's Individual Master File (IMF) and Business Master File (BMF) as the two oldest investments or systems at 56 years old each).

95 See Oral Statement of Robert Hamilton, MidPenn Legal Services Low Income Taxpayer Clinic, National Taxpayer Advocate Public Forum 9-10 (Apr. 8, 2016):

Major sources of delay in helping our clients is attempting to locate their notices, letters or records from the IRS, but the IRS already has, or should have, on file, particularly those documents submitted in connection with an audit.

The Form 2848, *Power of Attorney*, which our clients fill out at the beginning of representation, allows me to have access to their online transcripts, where I can obtain a clearer picture of what has transpired on their IRS account and where the taxpayer stands in the audit process; however, these transcripts only provide me with the dates of a notice or a letter that was issued, a short phrase summarizing that notice and the amount of the adjustment made to the client's account.

It would be much more useful if, for example, all of these documents could actually be uploaded, opened and viewed directly through the online services function; however, while these online upgrades and online interfaces could surely enhance my representation of taxpayers, I have serious doubts about taxpayers utilizing and relying exclusively on online services as a replacement to direct person-to-person contact with the IRS representatives.

96 See <https://taxpayeradvocate.irs.gov/public-forums>.

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The IRS has two of the oldest information systems in the federal government. Think about that — the nation’s revenue accounts are accessed and stored on five-decade old technology.

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*balance* the need for security with the need for access — security must be *paramount*. But the IRS must clearly acknowledge — to Congress, to the taxpaying public, and in its Future State plans — that there are consequences to the high level of security. Such high security means that only a limited segment of taxpayers will be able or willing to use the online account. The most recent data show that only 34 percent of taxpayers who attempted to create an online account were able to do so.<sup>97</sup> The taxpayers who sought to establish online accounts were the early adopters — the ones most eager and comfortable with online financial transactions. Yet even among that group, only one-third got through. That means two-thirds of the U.S. taxpayer population will still need telephone or face-to-face assistance.

As the IRS conducts its Taxpayer Digital Communication pilot this year, it will be interesting to see if taxpayers will be willing to engage digitally with the IRS in audits and other interactions.<sup>98</sup> If they agree to communicate via email, do they continue to do so throughout the audit, or do they revert to more personal methods such as phone calls? Will the IRS leverage technology to provide clear and individual explanations, or will taxpayers feel frustrated with the IRS templates for responses to questions and issues? Will IRS employees be able to respond to specific questions, or will they send canned responses? Will the IRS learn from these dialogues and update its responses and guidance? It hasn’t done that in its analog processes, so what is it about the Future State that makes us think it will do so in the digital environment?

### *The Consequences of Insufficient Information Technology (IT) Funding to Fundamental Tax Administration Operations*

The multiple demands on the IT function of the IRS create the same difficulties as the budget constraints on the IRS overall. In recent years, the IRS understandably has decided to focus most of its IT resources and talent on several major projects, including the Return Review Program (RRP), the Enterprise Case Management (ECM) system, International Data Exchange Service (IDES, for information sharing under FATCA and inter-government agreements), and Information Sharing and Reporting (IS&R, for Affordable Care Act implementation). But this approach leaves most of the IT needs of smaller functions, and even important projects for the larger functions, unfunded and unaddressed. Thus, chronic underfunding of the IRS IT function creates taxpayer burden and wasted resources from manual and unnecessary rework.

Even in areas that are currently the subject of major IT activity, the excuse of “no funding” arises. Currently, the IRS is moving to develop the RRP to replace the aging Electronic Fraud Detection System (EFDS).<sup>99</sup> But, as we discuss in a Most Serious Problem herein, a system is only as good as the intelligence that goes into it.<sup>100</sup> The IRS’s filters and business rules used for detecting fraudulent returns and identity theft had many false positive rates (FPRs) over 50 percent. This means that legitimate

97 The pass rate was 28 percent on Nov. 16, 2016, 29 percent on Nov. 17, 2016, and increased to 34 percent as of Dec. 18, 2016. IRS response to TAS Fact Check (Dec. 20, 2016).

98 For a discussion of TAS’s participation in the Taxpayer Digital Communication (TDC) pilot, see *TAS Case Advocacy*, *infra*.

99 W&I’s Business Modernization Office Return Review Program is a new integrated system that adds to the Service’s capability to detect, resolve and prevent criminal and civil tax non-compliance and fraud.

100 See Most Serious Problem: *Fraud Detection: The IRS’s Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*. See also Literature Review: “False Positive” Determinations in Fraud Detection, vol. 3, *infra*.

taxpayers are burdened unnecessarily while the IRS goes about its important work of detecting and stopping questionable returns.

In the private sector, financial and other institutions have found that false positives cost the business more through customer base erosion than does actual fraud. Thus, they have a strong incentive to minimize the rate and burden of false positives.

Because taxpayers cannot just leave the IRS and find themselves another tax administrator, it is incumbent on the IRS to respond *in real time* during the filing season to rules that have high false positive rates. Institutions throughout the government and the private sector accept the importance of using incoming data in real time to minimize false positives. When TAS recommended creating a dedicated sub-team of an IT Executive Steering Committee to accomplish programming approvals quickly, the IRS responded it already had an operational structure in place that addresses fraud model modifications in an almost real time atmosphere. Yet the Business Rules and Requirements Management office that must approve all business rule modifications does not meet regularly.<sup>101</sup> Thus, the IRS wastes the funds it does have by having to work the phone calls and letters from 1.2 million legitimate taxpayers whose \$9 billion in refunds were delayed.<sup>102</sup>

### Recommendation

The National Taxpayer Advocate recommends that Congress require the IRS to provide a detailed plan of its ECM strategy, including the RRP and the IRS strategy for reducing FPR in refund fraud detection, as well as a detailed report about the components and progress on the Taxpayer Advocate Service Integrated System (TASIS).<sup>103</sup>

101 See National Taxpayer Advocate FY 2017 Objectives Report to Congress, vol. 2, 23.

102 Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*.

103 For a discussion of TASIS, see Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Information System as a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.



## OFFICE OF THE TAXPAYER ADVOCATE: To protect taxpayer rights and ensure a fair and just tax system, Congress should take steps to strengthen the Taxpayer Advocate Service.

It has been 18 years since the establishment of the Office of the Taxpayer Advocate and the positions of National Taxpayer Advocate and Local Taxpayer Advocates under RRA 98. The Taxpayer Advocate Service (TAS) is now well-established. Since 2001, it has assisted about four million taxpayers in cases involving significant hardship, obtaining in whole or in part the relief taxpayers requested in over 75 percent of those cases. In the area of systemic advocacy, the IRS accepts, on average, more than half of our administrative recommendations, and enacted 32 of our legislative recommendations, including incorporating the Taxpayer Bill of Rights into the Code, and the IRS and Treasury have adopted additional recommendations by regulation.<sup>104</sup> The National Taxpayer Advocate has testified or submitted written testimony at over 60 congressional hearings, and the Annual Report to Congress is recognized as an important source of information about tax administration and taxpayer rights.

Our work in growing and strengthening TAS has not been without its challenges. Maintaining TAS's independence within an agency that is resistant to change and has a predilection for maintaining the status quo demands constant vigilance.<sup>105</sup> But over the years, progress has been made. The IRS senior leadership recognizes the important role TAS plays in reviewing IRS policies and actions, and acknowledges our role as an advocate for the taxpayer in those discussions.

Having sat at the IRS senior leadership table for almost 16 years (to our knowledge, longer than any other IRS official), the National Taxpayer Advocate is well aware of the challenges the IRS faces on a daily basis. But her job, and that of her employees, is to speak up for the taxpayers whose lives are impacted by the decisions the IRS makes daily in response to those challenges. This is very difficult work — trying to alter the course of an organization that is heading full-tilt in a particular direction.

The statutory framework of the Office of Taxpayer Advocate is what underlies the success of TAS. Without the strong language and structure of IRC §§ 7803(c) and 7811, the National Taxpayer Advocate would be a substanceless mouthpiece, and TAS a token gesture. But even a strong foundation can be improved. To enhance the effectiveness of the Office of the Taxpayer Advocate in advocating for taxpayers, the National Taxpayer Advocate offers the following ideas for consideration.

### *Reinforce the National Taxpayer Advocate's Right of Access to Taxpayer and IRS Information and to Meetings Between the IRS and Taxpayers*

By and large, the National Taxpayer Advocate and her employees have significant access to IRS systems and data. Yet over the years, both in the context of specific cases and systemic advocacy, including during the preparation of the Annual Report to Congress, the IRS has:

- Refused to allow the National Taxpayer Advocate and other TAS employees access to the audit files of taxpayers with cases open in TAS;
- Refused to allow the National Taxpayer Advocate and her employees to attend meetings between the IRS and taxpayers with cases open in TAS, even when the taxpayer him or herself requests TAS attendance;

104 See *National Taxpayer Advocate Legislative Recommendations with Congressional Action*, *infra*.

105 See *supra* for a discussion of IRS culture; see also *Most Serious Problem: IRS Structure: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *infra*.



- Refused to provide the National Taxpayer Advocate with data she requires for analyzing a most serious problem of taxpayers in the context of the Annual Report to Congress; and
- Refused to consent to publication of such data on the basis it is “official use only,” even though no exception or exclusion applies under the Freedom of Information Act.

IRC § 6103 sets out the confidentiality protections of tax returns and return information. It categorically states, “Returns and return information shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes.”<sup>106</sup> Under IRC § 7803(c), the National Taxpayer Advocate’s tax administration duties are extraordinarily broad, encompassing all of tax administration.<sup>107</sup> Therefore, there is no basis for the IRS to decline to make accessible to the National Taxpayer Advocate or her employees a taxpayer’s administrative file (including the audit file) relating to a case open or pending in TAS. Similarly, when a taxpayer requests that TAS participate in conferences or meetings between IRS employees and the taxpayer, there is no basis for the IRS to deny TAS that access.<sup>108</sup> Yet these refusals keep occurring. Therefore, the National Taxpayer Advocate recommends that Congress clarify the extent of TAS’s access to tax returns and tax return information with respect to cases open and pending in TAS, including the ability to participate in meetings between the taxpayer and the IRS, at the taxpayer’s request.

Moreover, where the National Taxpayer Advocate, in the course of exercising her statutory tax administration duties, identifies an issue as a most serious problem of taxpayers, or is investigating the systemic causes of taxpayer problems in general, there is no basis for the IRS to decline to make available to her any data, information, records it has compiled, or is preserving relating to that issue. However, because TAS has encountered numerous instances over the years in which IRS officials have declined to

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**Having sat at the IRS senior leadership table for almost 16 years, the National Taxpayer Advocate is well aware of the challenges the IRS faces on a daily basis. But her job, and that of her employees, is to speak up for the taxpayers whose lives are impacted by the decisions the IRS makes daily in response to those challenges. This is very difficult work — trying to alter the course of an organization that is heading full-tilt in a particular direction.**

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<sup>106</sup> IRC § 6103(h)(1).

<sup>107</sup> See IRC § 7803(c)(2)(A)(i)-(iv).

<sup>108</sup> See Oral Statement of Jim Oliver, Jim Oliver & Associates, PC., National Taxpayer Advocate Public Forum 37-38 (Aug. 30, 2016).

This was a very complex problem. The [taxpayer] advocate tracked down the IRS auditor in Ogden who was handling the problem. The IRS auditor in Ogden informed us with the advocate on the phone it was against policy for them to engage in a conference call with the advocate and a taxpayer representative at the same time. I don’t know that policy, but that’s what this person said and refused, refused to engage in a conference call where I needed to talk to how complex this problem was and how it needed to be fixed.

provide her access to certain information, the National Taxpayer Advocate recommends that Congress clarify her right to such information.<sup>109</sup>

### *Include Local Taxpayer Advocate Office Phone Numbers and Addresses in Statutory Notices of Deficiency*

IRC § 6212(a) provides that any notice proposing a deficiency of tax “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.” IRC § 7803(c)(2)(D)(i)(I) requires the National Taxpayer Advocate to “appoint local taxpayer advocates and make available at least 1 such advocate for each State.” Since the year 2000, when TAS first began its formal operations, the National Taxpayer Advocate has tried to get the IRS to include *on the Statutory Notice of Deficiency (SNOD)* the actual “location and phone number of the appropriate office.” As we discussed in an earlier Annual Report, the IRS has consistently declined to do so.<sup>110</sup>

In the past, the IRS and Chief Counsel maintained it satisfied this statutory mandate by including in the SNOD a stuffer notice listing all of the TAS local taxpayer advocate offices (Notice 1214), rather than the information pertaining to the *appropriate* office. With the IRS’s declining budget, the IRS in recent years has presented the National Taxpayer Advocate with a Hobson’s Choice — either agree to putting an internet address on the SNOD for taxpayer’s to look up the “appropriate” TAS location and phone number, or agree to TAS paying for the annual cost of printing at least three million Notices 1214 for inclusion in the SNODs.<sup>111</sup>

As we discussed earlier in this report, about one-third of the U.S. individuals do not have home broadband access, concentrated in lower income, elderly, and minority populations.<sup>112</sup> For these millions of taxpayers to access the internet to complete a search for a TAS local office, they must seek out wi-fi. And even so, they often have pay-as-you-go cell phone contracts. Thus, the use of a general internet address on the SNOD does not provide the mandated TAS contact information to a large swath of the taxpayer population. The alternative proposal of TAS endlessly paying for stuffer notices reduces funds available for its direct case advocacy on behalf of taxpayers. Instead, for a modest upfront investment, the IRS could develop a technology-based solution.

109 This issue arose recently in the context of this Annual Report to Congress. In an unprecedented move, the IRS declined to respond to the Enterprise Case Management (ECM)-related information requested by TAS as part of our development of a Most Serious Problem. The IRS took the position that ECM is internal to the IRS and “cannot be categorized as a most serious problem ‘encountered by taxpayers.’” IRS response to TAS research request (Nov. 3, 2016). Thus it declined to provide us with data and financial information the National Taxpayer Advocate had deemed necessary to her analysis of the problem. As such, TAS was unable to obtain the bulk of the information it sought to prepare this Most Serious Problem. TAS obtained the information used in this Most Serious Problem from external sources and from IRS information outside of the formal Most Serious Problem process. See Most Serious Problem: *Enterprise Case Management (ECM): The IRS’s ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Information System as a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

110 See National Taxpayer Advocate 2014 Annual Report to Congress 237-44 (Most Serious Problem: *Statutory Notices of Deficiency: Statutory Notices of Deficiency Do Not Include Local Taxpayer Office Contact Information on the Face of the Notices*).

111 The estimate of the cost for one year’s worth of Notice 1214 for SNODs issued by the Small Business/Self-Employed Operating Division was \$47,000. This does not include any SNODs issued by W&I with respect to Earned Income Tax Credit audits.

112 See discussion of taxpayer needs and preferences, *supra*; see also Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences is Critical as the IRS Develops an Online Taxpayer Account System* and Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, *infra*.

Since 2013, TAS has proposed that the IRS program its notice-generation system to allow for matching between the taxpayer's last known address (used on the notice) and the "location and phone number of the appropriate [local TAS] office." TAS has submitted Unified Work Requests (UWRs) to the IRS requesting such programming. To date, the IRS has denied all such requests. Therefore, in order to ensure that all taxpayers have the *right to a fair and just tax system*, the National Taxpayer Advocate recommends that Congress establish a date certain by which the IRS shall be required to complete programming for including the specific phone number and address of the appropriate local TAS office, based on the taxpayer's last known address.<sup>113</sup>

***Provide the National Taxpayer Advocate the Authority to Hire Independent Counsel, Comment on Regulations, and File Amicus Briefs in Litigation Raising Taxpayer Rights Issues***

The National Taxpayer Advocate is required by law to assist taxpayers in resolving problems with the IRS, to identify areas in which taxpayers have frequent problems or that are the subject of frequent litigation, and to identify administrative and legislative solutions to reduce controversy and mitigate such problems.<sup>114</sup> The mission of the Office of the Taxpayer Advocate would be advanced by additional statutory authority in three areas: *amicus curiae* briefs pertaining to taxpayer rights; the administrative rulemaking process; and the ability to hire independent counsel.

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The National Taxpayer Advocate is not authorized to participate in litigation.<sup>115</sup> While the conduct of relevant trials themselves may be best left to trial lawyers equipped to advocate zealously on behalf of individual clients, precedential issues of interest to numerous taxpayers may come before the judiciary with no one representing the rights of taxpayers in general. In the case of the Small Business Administration (SBA), the Chief Counsel for Advocacy has statutory authority to represent the interests of small businesses by appearing as *amicus curiae*.<sup>116</sup>

Although the National Taxpayer Advocate is charged with representing the interests of individuals, including low income taxpayers, there is no statutory requirement that the IRS address the National Taxpayer Advocate's comments before publishing final regulations. In the case of the SBA, the Chief Counsel for Advocacy has statutory authority to represent the interests of small businesses by providing comments that the IRS must consider before publishing any final regulation.<sup>117</sup> In the case of small businesses, Congress recognized this need by legislatively mandating regulatory review on their behalf by a counsel dedicated to this function. The rights of individual taxpayers, including low income taxpayers, may fall in a gap in regulatory review. While the National Taxpayer Advocate is often included in pre-publication circulation

<sup>113</sup> The right to a fair and just tax system means "[t]axpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels." IRS Pub. 1, *Your Rights as a Taxpayer* (Dec. 2014).

<sup>114</sup> IRC § 7803(c)(2)(A)(i)-(iv).

<sup>115</sup> See 28 U.S.C. § 516 ("Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice"); 5 U.S.C. § 3106 ("Except as otherwise authorized by law, the head of an Executive department or military department may not employ an attorney or counsel for the conduct of litigation in which the United States, an agency, or employee thereof is a party"); IRC § 7452 (indicating that the Secretary of the Treasury "shall be represented by the Chief Counsel"). See also Program Manager Tech. Assistance 00566, *Authority for the National Taxpayer Advocate to File Amicus Briefs with the Courts of the United States* (Oct. 2, 2002).

<sup>116</sup> 5 U.S.C. § 612(b).

<sup>117</sup> IRC § 7805(f).

of proposed or temporary regulations, the IRS is not required to address her comments in the published preambles to final regulations. The National Taxpayer Advocate believes that tax administration would be improved if the public knew what her concerns were with respect to regulations and how the IRS addressed (or did not address) those concerns.

When Congress reorganized the IRS in 1998, the Senate passed legislation providing for counsel to the National Taxpayer Advocate to be appointed by and report directly to the National Taxpayer Advocate and to operate within the Office of the Taxpayer Advocate.<sup>118</sup> In sponsoring this provision, Senator Charles Grassley (R-Iowa) offered the following rationale:

The purpose of doing this is to give the Taxpayer Advocate ready access to legal opinions and legal judgments. Currently, the Taxpayer Advocate must put requests into the Office of Chief Counsel. In order to make the Taxpayer Advocate more independent, which is what this bill does, it logically follows that the Taxpayer Advocate should have its own legal counsel. This will guarantee it fast, confidential legal advice to help those taxpayers in greatest need. Because it is the taxpayers in greatest need who go to the Taxpayer Advocate.<sup>119</sup>

This provision was eliminated in the conference agreement. Still, the conference report noted that the “conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate.”<sup>120</sup>

Accordingly, to assist the National Taxpayer Advocate in fulfilling her statutory duties, TAS employs several attorney-advisors and has done so for more than a decade. The first round of hiring began in 2003 after the National Taxpayer Advocate briefed the Commissioner, and it has continued since that time. TAS requires independent attorney-advisors because the office often takes positions, both in working taxpayer cases and in systemic advocacy, that are directly contrary to the position of the IRS and the Office of Chief Counsel. TAS attorney-advisors do not purport to offer formal legal advice or represent the agency, but they are indispensable in enabling the National Taxpayer Advocate to develop an independent perspective and advocate as the law intends.<sup>121</sup>

In 2015, we were informed that TAS’s longstanding ability to hire attorney-advisors within TAS is inconsistent with Treasury Department General Counsel Directive No. 2, which states: “Except for positions in the Inspectors General offices or within the Office of the Comptroller of the Currency, attorney positions shall not be established outside of the Legal Division” unless the General Counsel or Deputy General Counsel(s) provides a waiver. On November 29, 2016, the National Taxpayer Advocate submitted a memorandum to the Acting General Counsel, Department of the Treasury, requesting that Treasury General Counsel Directive No. 2 be modified to include the Office of the Taxpayer Advocate

118 H. REP. NO. 105-599, at 215 (1998) (Conf. Rep.).

119 144 Cong. REC. § 4460 (May 7, 1998) (statement of Sen. Grassley).

120 H. REP. NO. 105-599, at 216 (1998) (Conf. Rep.).

121 The Office of Chief Counsel has created the position of “Special Counsel to the National Taxpayer Advocate” to manage and coordinate Office of Chief Counsel support for the National Taxpayer Advocate and her headquarters employees. The Special Counsel and her staff are responsible for providing legal advice for programs and services related to the mission of TAS. The Special Counsel’s work is very helpful to the functioning of TAS in working many taxpayer cases, reviewing proposed regulations, coordinating with other divisions within the Office of Chief Counsel, reviewing training materials, and the like. However, the Special Counsel to the National Taxpayer Advocate reports to the IRS Chief Counsel and receives her performance reviews from the Chief Counsel. When the National Taxpayer Advocate wishes to articulate a position in her independent role that is contrary to the Office of Chief Counsel’s position, the Special Counsel is obligated to follow the position of the Chief Counsel.

along with the Inspectors General offices and the Office of the Comptroller of the Currency as Treasury offices excepted from the policy against hiring and employing attorney-advisors.<sup>122</sup>

### *Set TAS's Annual Appropriations Level Through a Separate Account Rather Than as Part of the IRS's Taxpayer Services Account*

The IRS is currently funded through four appropriations accounts — Taxpayer Services, Enforcement, Operations Support, and Business Systems Modernization. Funding for TAS is provided through the Taxpayer Services account, and except to the extent specified in an appropriations act, the IRS may decide how much funding to provide to TAS. This “power of the purse” may compromise TAS’s independence because the IRS can — explicitly or implicitly — penalize TAS if the National Taxpayer Advocate or other TAS employees criticize IRS policies and programs that they believe fail to respect taxpayer rights.

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In most years since FY 2006, the Appropriations Committees have addressed this concern by including language in appropriations acts that provides a minimum funding level for TAS. But the decision to provide a minimum TAS funding level is not institutionalized. It is made on an *ad hoc* basis from year to year. In most years, in fact, the Administration’s budget request asks that Congress *not* provide TAS with a minimum funding level,<sup>123</sup> and in some years, one house of Congress has specified a minimum funding level for TAS while the other has not.<sup>124</sup>

By creating a separate appropriation for TAS within the IRS budget — much like the Inspectors General have a separate appropriation with the Treasury Department’s budget — this independence issue can be resolved on a permanent basis.

### *Codify the Authority to Issue a Taxpayer Advocate Directive (TAD) and Clarify the Appeal Process Applicable to Taxpayer Assistance Orders (TAOs) and TADs*

IRC § 7811 authorizes the National Taxpayer Advocate to issue a TAO if she “determines the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.”<sup>125</sup> Only the National Taxpayer Advocate, the Commissioner of Internal Revenue, or the Deputy Commissioner of Internal Revenue may modify or

122 It is worth noting that as of Oct. 20, 2016, there were 278 attorney-advisors in the IRS whose positions were outside the Office of Chief Counsel. In addition to the attorneys in TAS, there were 238 attorney-advisors in the Small Business/Self-Employed Division’s estate and gift tax area (pursuant to an express waiver from General Counsel Directive No. 2), 14 attorneys in the Office of Professional Responsibility, six attorneys in the Large Business & International Division, four attorneys in the Human Capital Office, two attorneys in the Return Preparer Office, and one attorney each in the Commissioner’s Office, the Chief Financial Officer’s Office, and the Tax Exempt & Government Entities Division. IRS Human Resources Reporting Center (Oct. 10, 2016).

123 See, e.g., IRS, *Congressional Justification for FY 2015 Budget at IRS 95* (“The IRS supports adequate funding for the Taxpayer Advocate Service. Specifying the TAS funding level in law prevents the IRS from proposing an operating plan that allocates resources in the best interest of taxpayers”), <https://www.treasury.gov/about/budget-performance/CJ15/10.%20-%20FY2015.%20IRS%20CJ.pdf>.

124 For FY 2016, for example, the Senate bill provided a minimum funding level for TAS, but the House bill did not. Compare S. 1910, 114th Cong. (2015) with H.R. 2995, 114th Cong. (2015). For FY 2017, both houses provided a minimum funding level for TAS. See S. 3067, 114th Cong. (2016); H.R. 5485, 114th Cong. (2016).

125 IRC § 7811(a)(1)(A). IRC § 7811(b) establishes the terms of the Taxpayer Assistance Order (TAO).

rescind the TAO, and “only if a written explanation of the reasons for the modification or rescission is provided to the National Taxpayer Advocate.”<sup>126</sup>

Similarly, in the course of assisting taxpayers in resolving problems or identifying areas in which taxpayers have problems in dealing with the IRS, the National Taxpayer Advocate from time to time confronts procedural obstacles. In such cases, the Commissioner of Internal Revenue has delegated to the National Taxpayer Advocate the authority to issue TADs that direct IRS units to change procedures “to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.”<sup>127</sup> However, the IRS may not comply with or even respond to a TAD because it comes not under a statute but merely a delegated power that the Commissioner could revoke. In practice, the Commissioner or Deputy Commissioner, along with the National Taxpayer Advocate, may rescind or modify a TAD.<sup>128</sup>

### Recommendations

To enhance the independence of the Office of the Taxpayer Advocate and ensure that the rights of taxpayers, including the most vulnerable and unrepresented, are considered and protected in tax administration, regulations, and litigation, the National Taxpayer Advocate recommends that Congress:

1. Amend IRC § 7803(c) to clarify, pursuant to IRC § 6103(h)(1), that the National Taxpayer Advocate shall have access to tax returns and return information with respect to cases open and pending in TAS, and shall have the right to participate in meetings between taxpayers and the IRS when asked to do so by the taxpayer.
2. Amend IRC § 7803(c) to clarify that, in furtherance of her tax administration duties, the National Taxpayer Advocate shall have access to all data, statistical information, and documents necessary to perform a “full and substantive analysis” of the issues.<sup>129</sup>
3. Amend IRC § 6212(a) to require the IRS to include on and within the SNOD itself the specific phone number and address of the appropriate local TAS office, based on the taxpayer’s last known address.
4. Authorize the National Taxpayer Advocate to submit *amicus curiae* briefs in federal appellate litigation on matters relating to the protection of taxpayer rights.
5. Require the IRS to submit proposed or temporary regulations to the National Taxpayer Advocate on a pre-publication basis for comment within a reasonable time, and address those comments in the preamble to final regulations.
6. Authorize the National Taxpayer Advocate to appoint independent counsel who report directly to the National Taxpayer Advocate, provide independent legal advice, help prepare *amicus curiae* briefs and comments on proposed or temporary regulations, and assist the National Taxpayer Advocate in preparing the Annual Report to Congress and in advocating for taxpayers individually and systemically.
7. Create a separate appropriation for TAS within the IRS budget to ensure that TAS funding is controlled by Congress and not by IRS.

<sup>126</sup> IRC § 7811(c).

<sup>127</sup> Delegation Order 13-31 (formerly DO-250, Rev. 1), *reprinted* as IRM 1.2.50.4 (Jan. 17, 2001); see also IRM 13.2.1.6 (July 16, 2009).

<sup>128</sup> *Id.*

<sup>129</sup> IRC § 7803(c)(2)(B)(i).



8. Grant to the National Taxpayer Advocate non-delegable authority to issue a TAD with respect to any IRS program, proposed program, action, or failure to act that may create a significant hardship for a segment of the taxpayer population or for taxpayers at large, and require that, to object to a directive, the IRS would have to respond timely in writing.
9. Amend IRC § 7811 to clarify the process by which the IRS shall appeal a TAO, and require the Commissioner of Internal Revenue or the Deputy Commissioner of Internal Revenue to raise his or her objections to a TAO (*i.e.*, appeal the Order) issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the TAO. If the order is modified or rescinded, a detailed explanation of the reasons for such modification or rescission should be provided.<sup>130</sup>

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<sup>130</sup> See Taxpayer Rights Act of 2015, S. 2333, 114th Cong. §§ 401 & 402 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. §§ 401 & 402 (2015) (addressing aspects of Taxpayer Assistance Orders and Taxpayer Advocate Directives).

## TAXPAYER RIGHTS ASSESSMENT: IRS Performance Measures and Data Relating to Taxpayer Rights

In the 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that “... provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance.”<sup>1</sup>

On June 10, 2014, the IRS adopted a Taxpayer Bill of Rights (TBOR), a list of ten rights that the National Taxpayer Advocate recommended to help taxpayers and IRS employees alike gain a better understanding of the dozens of discrete taxpayer rights scattered throughout the multi-million word Internal Revenue Code.<sup>2</sup> While this was a significant achievement for increasing taxpayers’ awareness of their rights, and an important first step toward integrating taxpayer rights into all aspects of tax administration, more can be done. The *Taxpayer Rights Assessment* contains selected performance measures and data organized by the ten taxpayer rights and is one step toward integrating taxpayer rights into tax administration.

This *Taxpayer Rights Assessment* is a work in progress. The following data provide insights into IRS performance; however, they are by no means comprehensive. In some instances, data is not readily available. In other instances we may not yet have sufficient measures in place to address specific taxpayer rights. And, despite what the numbers may show, we must be concerned for those taxpayers who still lack access to services and quality service even when performance metrics are increasing. This *Taxpayer Rights Assessment* will grow and evolve over time as data becomes available and new concerns emerge.

- 1. THE RIGHT TO BE INFORMED** – Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

| Measure/Indicator   | Fiscal Year (FY) 2015 | FY 2016   |
|---|-----------------------|-----------|
| Individual Correspondence Volume (adjustments) <sup>a</sup>                         | 4,358,447             | 4,817,708 |
| Average cycle time to work Individual Master File (IMF) Correspondence <sup>b</sup> | 80 days               | 84 days   |
| Inventory overage <sup>c</sup>  | 68.3%                 | 49.1%     |
| Business Correspondence Volume (adjustments) <sup>d</sup>                           | 2,952,329             | 2,940,925 |
| Average cycle time to work Business Master File (BMF) Correspondence <sup>e</sup>   | 46 days               | 47 days   |
| Inventory overage <sup>f</sup>  | 18.8%                 | 8.6%      |
| Total Correspondence (all types)  | TBD                   | TBD       |
| Quality of IRS Forms & Publications   | TBD                   | TBD       |
| IRS.gov Web Page Ease of Use  | TBD                   | TBD       |
| IRS Outreach  | TBD                   | TBD       |

a IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016). The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress. These data on correspondence are also repeated under Right 4 – *The Right to Challenge the IRS’s Position and Be Heard*.

b IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

c IRS, *Weekly Enterprise Adjustments Inventory Report*, FY 2016 (week ending Oct. 1, 2016).

d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016).

e IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

f IRS, *Weekly Enterprise Adjustments Inventory Report*, FY 2016 (week ending Oct. 1, 2016).

- See National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface: *Taxpayer Service Is Not an Isolated Function but Must Be Incorporated Throughout All IRS Activities, Including Enforcement*).
- IRS, IR-2014-72, *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to Be Highlighted on IRS.gov, in Publication 1* (June 10, 2014).



**2. THE RIGHT TO QUALITY SERVICE** – Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

| Measure/Indicator  | FY 2015      | FY 2016      |
|--|--------------|--------------|
| Number of Returns Filed (projected, all types) <sup>a</sup>  | 245,821,318  | 248,898,800  |
| Total Individual Income Tax Returns <sup>b</sup>   | 148,840,642  | 151,027,600  |
| E-file Receipts, calendar year (Received by 12/04/15, 12/02/16) <sup>c</sup>   | 128,784,000  | 131,851,000  |
| E-file: Tax Professional (calendar year) <sup>d</sup>  | 61%          | 60%          |
| E-file: Self Prepared (calendar year) <sup>e</sup>   | 39%          | 40%          |
| <b>Returns Prepared by:</b>  |              |              |
| VITA/TCE/AARP (tax year) <sup>f</sup>  | 3,519,006    | 3,580,640    |
| Free File Consortium (tax year) <sup>g</sup>   | 2,588,934    | 2,356,167    |
| Fillable Forms (tax year) <sup>h</sup>   | 355,080      | 346,098      |
| Number of Taxpayer Assistance (“Walk-In”) Centers <sup>i</sup>   | 378          | 376          |
| Number of TAC Contacts <sup>j</sup>  | 5.6 million  | 4.5 million  |
| Total Calls to IRS <sup>k</sup>  | 116,679,405  | 117,479,981  |
| Number of Attempted Calls to IRS Customer Service Lines <sup>l</sup>   | 101,507,150  | 104,275,387  |
| Toll-Free: Percentage of calls answered (LOS) <sup>m</sup>   | 38.1%        | 53.4%        |
| Toll-Free: Average Speed of Answer <sup>n</sup>  | 30.5 minutes | 17.8 minutes |
| NTA Toll-Free: Percentage of calls answered (LOS) <sup>o</sup>   | 43.7%        | 58.1%        |
| NTA Toll-Free: Average Speed of Answer <sup>p</sup>  | 16.2 minutes | 8.9 minutes  |
| Practitioner Priority: Percentage of calls answered (LOS) <sup>q</sup>   | 47.6%        | 71.0%        |
| Practitioner Priority: Average Speed of Answer <sup>r</sup>  | 46.6 minutes | 10.5 minutes |
| Tax Exempt/Government Entities: Percentage of calls answered (LOS) <sup>s</sup>                                      | 60.2%        | 56.8%        |
| Tax Exempt/Government Entities: Average Speed of Answer <sup>t</sup>   | 23.4 minutes | 15.9 minutes |
| Toll-Free Customer Satisfaction <sup>u</sup>   | 87.0%        | 88.0%        |
| Awareness of Service (or utilization)  | TBD          | TBD          |
| IRS Issue Resolution – Percentage of taxpayers who had their issue resolved as a result of the service they received | TBD          | TBD          |
| Taxpayer Issue Resolution – Percentage of taxpayers who reported their issue was resolved after receiving service    | TBD          | TBD          |

a IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2016-2023* (Aug. 2016), at 4. The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress to report actual return counts. The FY 2016 figures are projected numbers. The number of returns and related metrics are proxies for IRS workload and provide context for the environment in which taxpayers seek Quality Service and other rights.

b IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2016-2023* (Aug. 2016), at 4. The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress to report actual return counts.

c IRS, Filing Season Statistics, available at <https://www.irs.gov/uac/newsroom/filing-season-statistics-for-week-ending-december-second-2016> (last visited Dec. 12, 2016).

d *Id.*

e *Id.*

f Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly, and AARP Tax-Aide programs. IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File. The FY 2015 figure represents tax year 2014 returns. The FY 2016 figures represent tax year 2015.

g IRS, CDW, Electronic Tax Administration Marketing Database.

h *Id.*

i FY 2015 figures from W&I analyst (Dec. 13, 2016). FY 2016 figure from W&I response to TAS fact check (Dec. 20, 2016). In the 2015 Annual Report to Congress we reported a different figure for 2015 (380) which reflected the number of TACs open during the filing season.

j W&I, Business Performance Review (BPR), 4th Quarter, FY 2016 (Nov. 9, 2016) at 7.

k IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016; report generated Nov. 5, 2016).

l *Id.* Number of calls to Accounts Management (formerly Customer Services) is the sum of 29 lines (0217, 1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 9887, 9982, 4184, 7388, 0452, 0352, 7451, 9946, 5215, 3536, 2050, 4017, 2060, 4778, 4259, 8482, 8775, 5500, 4490, and 5640).

m IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016; report generated Nov. 5, 2016). Accounts Management calls answered include reaching live assistant or selecting options to hear automated information messages.

n *Id.*

Footnotes continued on next page. ➤

(Continued from previous page.)

- o IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2016; report generated Nov. 5, 2016).  
 p *Id.*  
 q *Id.*  
 r *Id.*  
 s *Id.*  
 t *Id.*  
 u W&I, BPR, 4th Quarter, FY 2016 (Nov. 9, 2016), at 12.

**3. THE RIGHT TO PAY NO MORE THAN THE CORRECT AMOUNT OF TAX** – Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

| Measure/Indicator   | FY 2015 | FY 2016 |
|---|---------|---------|
| Toll-Free Tax Law Accuracy <sup>a</sup>                                 | 95.0%   | 96.4%   |
| Toll-Free Accounts Accuracy <sup>b</sup>                                | 95.5%   | 96.1%   |
| Scope of Tax Law Questions Answered                                     | TBD     | TBD     |
| <b>Correspondence Examinations (Form 1040 Series)</b>                   |         |         |
| No change rate <sup>c</sup>   | 17.3%   | 16.2%   |
| Agreed rate <sup>d</sup>  | 16.3%   | 20.6%   |
| Non-response rate <sup>e</sup>  | 48.3%   | 42.1%   |
| Percentage of cases appealed  | TBD     | TBD     |
| <b>Field Examinations (Form 1040 Series)</b>                            |         |         |
| No change rate <sup>f</sup>   | 15.3%   | 14.6%   |
| Agreed rate <sup>g</sup>  | 45.7%   | 45.4%   |
| Non-response rate <sup>h</sup>  | 0.3%    | 0.3%    |
| Percentage of cases appealed  | TBD     | TBD     |
| <b>Office Examinations (Form 1040 Series)</b>                           |         |         |
| No change rate <sup>i</sup>   | 13.5%   | 12.2%   |
| Agreed rate <sup>j</sup>  | 44.7%   | 43.4%   |
| Non-response rate <sup>k</sup>  | 19.8%   | 20.6%   |
| Percentage of cases appealed  | TBD     | TBD     |
| Math Error Adjustments  | TBD     | TBD     |
| Math Error Abatements   | TBD     | TBD     |
| Number of Statutory Notices of Deficiency Issued                        | TBD     | TBD     |
| Number of Statutory Notices of Deficiency Appealed                      | TBD     | TBD     |
| Number of Collection Appeals Program Conferences                        | TBD     | TBD     |
| Number of Collection Appeals Program Conferences Reversing IRS position | TBD     | TBD     |
| Number of Collection Due Process Conferences                            | TBD     | TBD     |
| Number of Collection Due Process Conferences Reversing IRS position     | TBD     | TBD     |

- a W&I, BPR, 4th Quarter, FY 2016 (Nov. 9, 2016), at 4.  
 b *Id.*  
 c IRS, CDW, Audit Information Management System, Closed Case Database.  
 d *Id.*  
 e *Id.*  
 f *Id.*  
 g *Id.*  
 h *Id.*  
 i *Id.*  
 j *Id.*  
 k *Id.*

- 4. THE RIGHT TO CHALLENGE THE IRS'S POSITION AND BE HEARD** – Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

| Measure/Indicator   | FY 2015   | FY 2016   |
|---|-----------|-----------|
| Individual Correspondence Volume (adjustments) <sup>a</sup>                               | 4,358,447 | 4,817,708 |
| Average cycle time to work Individual Master File Correspondence <sup>b</sup>             | 80 days   | 84 days   |
| Inventory overage <sup>c</sup>  | 68.3%     | 49.1%     |
| Business Correspondence Volume (adjustments) <sup>d</sup>                                 | 2,952,329 | 2,940,925 |
| Average cycle time to work Business Master File Correspondence <sup>e</sup>               | 46 days   | 47 days   |
| Inventory overage <sup>f</sup>  | 18.8%     | 8.6%      |
| Percentage of Math Error Adjustments Abated   | TBD       | TBD       |
| Percentage of Statutory Notices of Deficiency Appealed to Tax Court                       | TBD       | TBD       |
| Number of Collection Appeal Program (CAP) Conferences Requested by Taxpayers <sup>g</sup> | TBD       | TBD       |
| Percentage of CAP Conferences that Reversed the IRS Position                              | TBD       | TBD       |
| Number of Collection Due Process (CDP) Hearings Requested by Taxpayers <sup>h</sup>       | TBD       | TBD       |
| Percentage of CDP Hearings that Reversed the IRS Position                                 | TBD       | TBD       |

a IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016). The FY 2015 figure has been updated from what we reported in the 2015 Annual Report to Congress.

b IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

c IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2016* (week ending Oct. 1, 2016).

d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016).

e IRS, JOC, *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

f IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2016* (week ending Oct. 1, 2016).

g Taxpayers may request a Collection Appeals Process review as the result of IRS actions such filing a Notice of Federal Tax Lien, an IRS levy or seizure of property, and termination, rejection, or modification of an installment agreement. See IRS Pub. 1660, *Collection Appeal Rights*.

h Taxpayers may request a Collection Due Process review when the IRS plans to take actions such as filing a federal tax lien or levy. See IRS Pub. 1660, *Collection Appeal Rights*.

- 5. THE RIGHT TO APPEAL AN IRS DECISION IN AN INDEPENDENT FORUM** – Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court.

| Measure/Indicator  | FY 2015 | FY 2016 |
|--|---------|---------|
| Number of Cases Appealed <sup>a</sup>                                  | 113,870 | 114,362 |
| Appeals Staffing (On-rolls) <sup>b</sup>                               | 1,569   | 1,449   |
| Number of States without an Appeals or Settlement Officer <sup>c</sup> | 11      | 10      |
| Customer Satisfaction of Service in Appeals <sup>d</sup>               | TBD     | TBD     |
| Average Days in Appeals to Resolution                                  | TBD     | TBD     |
| Percentage of Statutory Notices of Deficiency Appealed to Tax Court    | TBD     | TBD     |

a Office of Appeals, BPR, 4th Quarter FY 2016 (Nov. 7, 2016), at 8.

b *Id.* at 10.

c IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/posrpt.htm>. Employee Position (OF8) Listing for weeks ending Oct. 3, 2015 and Oct. 1, 2016.

d Appeals awarded a new contract for collecting customer satisfaction data during FY 2016; data not yet available. Office of Appeals, BPR, 4th Quarter FY 2016 (Nov. 7, 2016), at 8.

- 6. THE RIGHT TO FINALITY** – Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

| Measure/Indicator   | FY 2015  | FY 2016  |
|---|----------|----------|
| Average Days to Complete Correspondence Examination (non-EITC) <sup>a</sup>             | 231 days | 196 days |
| Average Days to Complete Correspondence Examination (EITC) <sup>b</sup>                 | 221 days | 217 days |
| Average Days to Reach Determination on Applications for Exempt Status <sup>c</sup>      | 83 days  | 54 days  |
| Average Days for Exempt Organization Function to Respond to Correspondence <sup>d</sup> | 175 days | 45 days  |

a W&I, BPR, 4th Quarter, FY 2016 (Nov. 9, 2016), at 8.

b *Id.*

c Tax Exempt and Government Entities (TE/GE), Business Performance Review, 4th Quarter FY 2016 (Dec. 5, 2016), at 18.

d TE/GE, BPR, 4th Quarter FY 2016 (Dec. 5, 2016), at 20.

- 7. THE RIGHT TO PRIVACY** – The right to privacy goes to the right to be free from unreasonable searches and seizures and that IRS actions would be no more intrusive than necessary. Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

| Measure/Indicator   | FY 2015 | FY 2016 |
|---|---------|---------|
| Number (or percentage) of Collection Due Process cases where IRS cited for Abuse of Discretion  | TBD     | TBD     |
| Number of Offers in Compromise Submitted using 'Effective Tax Administration' as Basis          | TBD     | TBD     |
| Percentage of Offers in Compromise Accepted that used 'Effective Tax Administration' as Basis   | TBD     | TBD     |
| Number of cases where taxpayer received repayment of attorney fees as result of final judgment. | TBD     | TBD     |

- 8. THE RIGHT TO CONFIDENTIALITY** – Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

| Measure/Indicator   | FY 2015 | FY 2016 |
|---|---------|---------|
| Number of Closed Unauthorized Access of Taxpayer Account (UNAX) Investigations <sup>a</sup>               | 173     | 147     |
| UNAX Investigations Resulting in Prosecution, Removal, Resignation or Suspension of Employee <sup>b</sup> | 70      | 38      |
| UNAX Investigations Resulting in other Administrative Dispositions <sup>c</sup>                           | 83      | 81      |
| UNAX Investigations Where Employee Cleared of Wrongdoing <sup>d</sup>                                     | 20      | 28      |

a Automated Labor and Employee Relations Tracking System (ALERTS). The number of IRS employees averaged 89,251 in FY 2015 and 85,002 in FY 2016. IRS, Human Resources Reporting Center, *Fiscal Year Population Report*.

b ALERTS.

c *Id.* Administrative dispositions includes alternative discipline in lieu of suspension; case cancelled or merged with another case; caution letter; last chance agreement; oral counseling; reprimand; written counseling; etc.

d ALERTS.

**9. THE RIGHT TO RETAIN REPRESENTATION** – Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

| Measure/Indicator  | FY 2015        | FY 2016        |
|--|----------------|----------------|
| Percentage of Power of Attorney Requests overage (as of 9/26/15, 10/1/16) <sup>a</sup> | 0%             | 0%             |
| Number of Low Income Taxpayer Clinics Funded (calendar year) <sup>b</sup>              | 132            | 138            |
| Funds Appropriated for Low Income Taxpayer Clinics <sup>c</sup>                        | \$10.0 million | \$12.0 million |
| Number of States with a Low Income Taxpayer Clinic (calendar year) <sup>d</sup>        | 49             | 49             |
| Number of Low Income Taxpayer Clinic Volunteer Hours (calendar year) <sup>e</sup>      | 54,164         | 60,669         |

a IRS, JOC, *Customer Account Services, Accounts Management Paper Inventory Reports* (weeks ending 9/26/2015 and 10/1/2016).

b IRS Pub. 5066, *Low Income Taxpayer Clinics Program Report* (Dec. 2015, Jan. 2017).

c Consolidated and Further Continuations Appropriations Act, 2015, Pub. L. No. 113-235, enacted Dec. 16, 2014. Consolidated Appropriations Act, 2016, Pub. Law 114-113, enacted Dec. 18, 2015. The amounts actually awarded to Low Income Taxpayer Clinics (LITCs) are made on a calendar year basis, and differed from the appropriated amounts. The IRS contributed an additional \$0.25 million in 2015 bringing the total to \$10.25 million. The amount awarded to clinics in 2016 was \$11.4 million based on the number of available grantees who met the requirements.

d IRS Pub. 5066, *Low Income Taxpayer Clinics Program Report* (Dec. 2015, Jan. 2017). Forty-nine states and the District of Columbia have at least one LITC. Currently there is no LITC in North Dakota.

e Form 13424-A, *Low Income Taxpayer Clinic (LITC) General Information Report* (Apr. 2016). LITC grantees are required to submit this form which includes the number of volunteer hours. The LITC program office aggregates the calendar year totals. The FY 2015 figure reflects volunteer hours from calendar 2014. The FY 2016 figure reflects volunteer hours from calendar 2015.

**10. THE RIGHT TO A FAIR AND JUST TAX SYSTEM** – Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

| Measure/Indicator  | FY 2015   | FY 2016   |
|--|-----------|-----------|
| Offer in Compromise (OIC): Number of Offers Submitted <sup>a</sup>                         | 66,600    | 64,479    |
| Offer in Compromise: Percentage of Offers Accepted <sup>b</sup>                            | 42.5%     | 42.5%     |
| Installment Agreements (IAs): Number of Individual & Business IAs <sup>c</sup>             | 2,986,121 | 3,115,404 |
| Streamlined Installment Agreements: Number of Individual & Business IAs <sup>d</sup>       | 2,567,623 | 2,630,811 |
| Installment Agreements: Number of Individual & Business IAs <sup>e</sup>                   | 52,053    | 42,978    |
| Streamlined Installment Agreements (CFF): Number of Individual & Business IAs <sup>f</sup> | 10,679    | 8,477     |
| Number of OICs Accepted per Revenue Officer <sup>g</sup>                                   | 7.4       | 7.7       |
| Number of IAs Accepted per Revenue Officer <sup>h</sup>                                    | 14.0      | 12.0      |
| Percentage of Cases in the Queue (Taxpayers) <sup>i</sup>                                  | 15.7%     | 15.5%     |
| Percentage of Cases in the Queue (Modules) <sup>j</sup>                                    | 24.7%     | 23.9%     |
| Percentage of TDAs reported Currently Not Collectible - Tolerance <sup>k</sup>             | 16.3%     | 16.9%     |
| Age of Delinquencies in the Queue <sup>l</sup>   | 4.5 years | 4.5 years |
| Percentage of Modules in the Queue prior to three tax years ago <sup>m</sup>               | 79.2%     | 78.7%     |
| Percentage of Cases where the taxpayer is fully compliant after five years <sup>n</sup>    | 44%       | 48%       |

a IRS, Collection Activity Report No. 5000-108, FY 2015 (Oct. 4, 2015) and (Oct. 7, 2016).

b *Id.*

c IRS, Collection Activity Report No. 5000-6, FY 2015 (Dec. 9, 2015) and FY 2016 (Oct. 3, 2016).

d *Id.*

e *Id.*

f *Id.*

g *Id.* See also IRS Human Resources Reporting Center – number of revenue officers in SB/SE as of the end of FY 2015 and FY 2016 (pay period 19).

h *Id.*

i IRS, Collection Activity Report No. 5000-2, FY 2015 (Oct. 5, 2015) and (Oct. 3, 2016).

j *Id.*

k IRS Collection Activity Report No. 5000-149 FY 2015 (Oct. 5, 2015) and FY 2016 (Oct. 3, 2016).

l Accounts Receivable Dollar Inventory. Age of cases in the collection queue as of cycle 37 of 2015 and 2016.

m IRS, Collection Activity Report No. 5000-2, FY 2015 (Oct. 5, 2015) and (Oct. 3, 2016).

n Calculation by TAS Research. Percentage of taxpayers with tax delinquent accounts in 2010 and 2011, respectively, and who have no new delinquencies five years later. IRS, CDW, Individual Master File (IMF).

## INTRODUCTION: The Most Serious Problems Encountered by Taxpayers

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2016, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 20 such problems. This year's report also includes a special focus on the IRS's Future State and the National Taxpayer Advocate's vision for a taxpayer-centric 21st century tax administration.

As in earlier years, this report discusses at least 20 of the most serious problems encountered by taxpayers — but not necessarily *the top 20* most serious problems. That is by design. Since there is no objective way to select the 20 most serious problems, we consider a variety of factors when making this determination. Moreover, while we carefully rank each year's problems under the same methodology (described below), the list remains inherently subjective in many respects.

To simply report on the top 20 problems would limit our effectiveness in focusing congressional, IRS, and public attention on critical issues. It would require us to repeat much of the same data and propose many of the same solutions year to year. Thus, the statute gives the National Taxpayer Advocate flexibility in selecting both the subject matter and the number of topics discussed and to use the report to put forth actionable and specific solutions instead of mere criticism and complaints.

### Methodology of the Most Serious Problem List

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. In many years, the National Taxpayer Advocate identifies a theme or groupings of issues for the report that is reflected in the selection of issues. For example, this year the themes are:

- *Elements of the Future State;*
- *Necessary Tools for Achieving the Future State; and*
- *Taxpayer Rights and Issue Resolution in the Future State.*

The 20 issues in this year's report are ranked according to the following criteria:

- Impact on taxpayer rights;
- Number of taxpayers affected;
- Interest, sensitivity, and visibility to the National Taxpayer Advocate, Congress, and other external stakeholders;
- Barriers these problems present to tax law compliance, including cost, time, and burden;
- The revenue impact of noncompliance; and
- Taxpayer Advocate Management Information System (TAMIS) and Systemic Advocacy Management System (SAMS) data.

Finally, the National Taxpayer Advocate and the Office of Systemic Advocacy examine the results of the ranking and adjust it where editorial or numerical considerations warrant a particular placement or grouping.

### Taxpayer Advocate Management Information System (TAMIS) List

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy — using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in Fiscal Year 2016, a period spanning October 1, 2015, through September 30, 2016.

### Use of Examples

The examples presented in this report illustrate issues raised in cases handled by TAS. To comply with IRC § 6103, which generally requires the IRS to keep taxpayer returns and return information confidential, the details of the fact patterns have been changed. In some instances, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to that taxpayer's case. These exceptions are noted in footnotes to the examples.

MSP  
#1**VOLUNTARY COMPLIANCE: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Debra Holland, Commissioner, Wage and Investment Division  
 Sunita Lough, Commissioner, Tax Exempt and Government Entities Division  
 Douglas W. O'Donnell, Commissioner, Large Business and International Division  
 Benjamin Herndon, Director, Research, Applied Analytics and Statistics

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM<sup>2</sup>**

Insights from behavioral science (*e.g.*, psychology and behavioral economics) reveal that people generally do not perform an elaborate economic analysis when making decisions. For example, they may do what is easy, do what they think others are doing (*i.e.*, follow norms), respond more readily to messages that are clear and relevant, and cheat only if they can maintain a positive self-image (*e.g.*, tax morale).<sup>3</sup>

Such behavioral insights (BIs) help explain why economic deterrence is not the IRS's only lever. They suggest the IRS can directly improve tax compliance by simplifying the rules, explaining them to taxpayers, highlighting apparent reporting and payment discrepancies, and responding promptly and clearly to inquiries, among other things. Moreover, tax administrators around the world have been using randomized controlled trials (RCT) to quantify the return on investment (ROI) and compliance gains that result from such alternative treatments.

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Behavioral Science Lessons for Taxpayer Compliance*, vol. 3, *infra*.
- 3 See *generally* Richard Thaler, *MISBEHAVING: THE MAKING OF BEHAVIORAL ECONOMICS* (2015) (overview); Dan Ariely, *PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS* (2008) (overview); Dan Ariely, *THE HONEST TRUTH ABOUT DISHONESTY: HOW WE LIE TO EVERYONE — ESPECIALLY OURSELVES* (2012) (discussing self-image); Daniel Kahneman, *THINKING, FAST AND SLOW* (2011) (discussing mental shortcuts); Jonah Berger, *INVISIBLE INFLUENCE: THE HIDDEN FORCES THAT SHAPE BEHAVIOR* (2016) (discussing norms).



Following recommendations by the National Taxpayer Advocate and an Executive Order, the IRS is also pursuing BI research using RCTs.<sup>4</sup> However, it does not report the resulting “service” revenue or compliance gains as routinely as it reports so-called “enforcement” revenue and productivity.<sup>5</sup> As a result, even if the IRS identifies effective alternative treatments, it may underuse them and overuse enforcement. Moreover, the taxpayer’s *right to privacy*, which includes the right to expect that any IRS inquiry or enforcement action will “be no more intrusive than necessary,” requires the IRS to try alternative treatments before resorting to coercion.<sup>6</sup> Further, unnecessary coercion wastes resources, burdens taxpayers, and may even reduce voluntary compliance and overall tax revenue (*i.e.*, in other years or due from other taxpayers).<sup>7</sup>

## ANALYSIS OF PROBLEM

### Non-Economic Factors Affect Tax Compliance

Most people voluntarily report and pay their taxes. About 98 percent of all tax revenue results from voluntary compliance, as compared to about two percent from “enforcement” revenue.<sup>8</sup> Taxpayers report nearly all of the income that is subject to withholding and third-party information reporting (*e.g.*, wage and salary income).<sup>9</sup>

Withholding and information reporting procedures use several BIs, such as the insight that people are motivated by:

- (1) Defaults and loss aversion: It is easier to report income already reflected on information returns and less painful to claim withholding credits for amounts already paid;
- (2) Timing: Information returns arrive when needed at year end;
- (3) Tax morale and visibility: It is more difficult to omit income that is visible on information returns while thinking of yourself as honest;

4 See, *e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 156-61 (Most Serious Problem: *Taxpayer Service and Behavioral Research*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-50 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*); National Taxpayer Advocate 2014 Annual Report to Congress 112-22 (Most Serious Problem: *The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy*); Executive Order 13707, 80 Fed. Reg. 56365 (Sept. 15, 2015), <https://www.gpo.gov/fdsys/granule/FR-2015-09-18/2015-23630>.

5 See, *e.g.*, IRS, *Fiscal Year 2015 Enforcement and Service Results* (Mar. 8, 2016), <https://www.irs.gov/uac/newsroom/fiscal-year-2015-enforcement-and-service-results>. When we use the term “enforcement” in quotes we are referring to its overly-broad definition (*e.g.*, any action by a so-called IRS “enforcement” function), and when we use it without quotes we are referring to its more natural meaning — the IRS’s use of coercive power to compel action (*e.g.*, assessment, summons, lien, levy, and the withholding of refunds). See THE OXFORD ENGLISH DICTIONARY, [http://www.oxforddictionaries.com/us/definition/american\\_english/enforcement](http://www.oxforddictionaries.com/us/definition/american_english/enforcement) (“The act of compelling ...”) and Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*. For further discussion of this issue, see Nina Olson, *The Future of Tax Administration*, 2016 TNT 49-11 (Mar. 10, 2016).

6 TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

7 See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 1-14 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*); Norman Gemmell & Marisa Ratto, *Behavioral Responses to Taxpayer Audits: Evidence From Random Taxpayer Inquiries*, 65 NAT. TAX J. 33-58 (2012); National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-100 (*Audit Impact Study*).

8 In Fiscal Year (FY) 2015, the IRS collected total tax revenue of about \$3.3 trillion. Government Accountability Office (GAO), GAO-17-140, *Financial Audit: IRS’s Fiscal Years 2016 and 2015 Financial Statements* 25 (Nov. 10, 2016), <http://www.gao.gov/products/GAO-17-140>. Of that amount, it collected \$54.3 billion through enforcement actions. *Id.*

9 See IRS, Research, Applied Analytics & Statistics (RAAS), *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2008–2010*, 12 (May 2016), <https://www.irs.gov/pub/irs-soi/p1415.pdf> (estimating the net misreporting for wage and salary income at about one percent).

- (4) Social norms and salience: When a third party reports income to you on a Form W-2 or 1099, he or she identifies specific income and suggests that reporting it is the norm; and
- (5) Deterrence: The omission of income reported to the IRS by third parties is more likely to be detected and punished.<sup>10</sup>

Even where income is not subject to information reporting, some have suggested that relatively high levels of tax compliance cannot be explained by economic deterrence alone.<sup>11</sup> Taxpayers comply (or fail to do so) for a wide variety of non-economic reasons.<sup>12</sup> Research suggests that trust, social norms, fairness, reciprocity, tax morale, and similar non-economic factors also drive tax compliance.<sup>13</sup> Virtually all taxpayers (94 percent) surveyed by the IRS Oversight Board in 2014 expressed non-economic motives, mostly or completely agreeing that “it is every taxpayer’s civic duty to comply.”<sup>14</sup> Some tax administrators report that norms are the most important non-economic factor, though other factors can affect norms.<sup>15</sup> For example, economic deterrence can either crowd out compliance norms (*e.g.*, by suggesting that most people do not comply without coercion) or support them.<sup>16</sup>

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- 10 For a discussion of tax-related insights, see, *e.g.*, Andrew Reeson and Simon Dunstall, *Behavioural Economics and Complex Decision-Making Implications for the Australian Tax and Transfer System* iii (CMIS Rept. No. 09/110, 2009), [http://taxreview.treasury.gov.au/content/html/commissioned\\_work/downloads/CSIRO\\_AFTS\\_Behavioural\\_economics\\_paper.pdf](http://taxreview.treasury.gov.au/content/html/commissioned_work/downloads/CSIRO_AFTS_Behavioural_economics_paper.pdf). See also Nina Mazar *et al.*, *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MARKETING RES. 633-644 (2008).
  - 11 See, *e.g.*, Erich Kirchler *et al.*, *Why Pay Taxes?: A Review of Tax Compliance Decisions* 18 (Georgia State Univ., Int’l Studies Prog., Working Paper 07-30, 2007), <http://icepp.gsu.edu/files/2015/03/ispwp0730.pdf>. Similarly, one study found that about 20 percent fully paid a church tax, even though they knew the tax was not enforced. See Nadja Dwenger *et al.*, *Extrinsic and Intrinsic Motivations for Tax Compliance: Evidence from a Field Experiment in Germany*, 8 AM. ECON. J. 203, 204-05 (2016). Others have tried to explain how deterrence could produce the observed levels of compliance. See, *e.g.*, Mark Phillips, *Reconsidering the Deterrence Paradigm of Tax Compliance*, IRS Research Conference (2011).
  - 12 Social scientists have identified at least eight types of noncompliance, including: Procedural, Lazy, Unknowing, Asocial, Brokered, Symbolic, Social, and Habitual. See Robert Kidder and Craig McEwen, *Taxpaying Behavior in Social Context: A Tentative Typology of Tax Compliance and Noncompliance*, in *TAXPAYER COMPLIANCE*, Vol. 2, 47-72 (Jeffrey Roth & John Scholz, eds., 1989).
  - 13 See, *e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-50 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-28; OECD, Forum on Tax Administration, Small/Medium Enterprise (SME) Compliance Subgroup, *Understanding and Influencing Taxpayers’ Compliance Behaviour* (Nov. 2010); OECD, Forum on Tax Administration Subgroup, *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012); Tom Tyler, *Why People Obey the Law* (2006); Tom Tyler, *Legitimacy and Criminal Justice: The Benefits of Self-Regulation*, 7 OHIO ST. J. CRIM. L. 307-359 (Fall 2009); Erich Kirchler, *THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOUR* (2007).
  - 14 IRS Oversight Board, *2014 Taxpayer Attitude Survey* 8 (Dec. 2014), <https://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf>.
  - 15 Organisation for Economic Co-operation and Development (OECD), Forum on Tax Administration, Small/Medium Enterprise (SME) Compliance Subgroup, *Understanding and Influencing Taxpayers’ Compliance Behaviour* 21 (Nov. 2010). This is consistent with studies finding that norms, trust for the government, and trust for the IRS are correlated with estimated reporting compliance by small business. See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*). In addition, these factors may vary by locale. See National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).
  - 16 See, *e.g.*, Steven Sheffrin and Robert Triest, *Can Brute Deterrence Backfire? Perceptions and Attitudes in Taxpayer Compliance*, in *WHY PEOPLE PAY TAXES: TAX COMPLIANCE AND ENFORCEMENT* (Joel Slemrod, ed., 1992); Dan M. Kahn, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71 (2003); Bruno S. Frey & Lars P. Feld, *Deterrence and Morale in Taxation: An Empirical Analysis* 7 (CESifo Working Paper Series No. 760, 2002). See also James Heyman & Dan Ariely, *Effort for Payment: A Tale of Two Markets*, 15 PSYCH. SCI. 787, 792-93 (2004) (suggesting that because people sometimes expend more effort in exchange for no payment (a social market) than when they receive low payment (a monetary market), adding monetary incentives can reduce those efforts); Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUDIES 1 (2000) (introducing a fine for late daycare pickups increased late pickups).

### Unnecessary Coercion Can Reduce Voluntary Compliance

When the IRS adopts fair procedures designed to help taxpayers comply, it makes compliance easier and sends the message that most people are trying to comply, supporting compliance norms. Fair procedures also promote the view that the agency is legitimate and trustworthy, potentially making it more difficult for people to justify noncompliance while maintaining a positive self-image.<sup>17</sup> Perhaps because unnecessary coercion erodes these perceptions, research suggests that it can reduce voluntary compliance.<sup>18</sup> As a result, the IRS's efforts could be misdirected if it focuses primarily on direct "enforcement" results and efficiencies (*e.g.*, closures, cycle time, and dollars assessed or collected), which it often quantifies and highlights for stakeholders.<sup>19</sup>

### The IRS May Underuse Alternative Treatments Because It Has Difficulty Measuring Their Effectiveness

During the 1990s, the IRS and its stakeholders recognized that to be effective the IRS would have to identify the root causes of noncompliance by specific taxpayer segments (*e.g.*, confusion, local norms, competitive pressures, and economic conditions), and use a tailored multi-functional approach to address them (called "Compliance 2000").<sup>20</sup> Largely because it was difficult for the IRS to measure the revenue and compliance gains from such alternative treatments, however, Compliance 2000 lost support.<sup>21</sup>

- 17 See generally Tom R. Tyler, *The Psychology of Self-Regulation: Normative Motivations for Compliance*, in EXPLAINING COMPLIANCE: BUSINESS RESPONSES TO REGULATION 78 (Christine Parker & Vibeke Nielsen eds., 2011); Kristina Murphy, *Procedural Justice and the Regulation of Tax Compliance*, in DEVELOPING ALTERNATIVE FRAMEWORKS FOR EXPLAINING TAX COMPLIANCE 191, 208 (James Alm et al. eds., 2010).
- 18 See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 1-14 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*) (finding small businesses subject to an accuracy-related penalty had lower estimated subsequent compliance if the penalty was assessed by default, was abated, or was appealed, suggesting that penalties perceived as unfair may reduce future compliance); Norman Gemmell & Marisa Ratto, *Behavioral Responses to Taxpayer Audits: Evidence From Random Taxpayer Inquiries*, 65 NAT. TAX J. 33-58 (Mar. 2012) (suggesting that audits of compliant taxpayers may reduce voluntary compliance); National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 1-100 (*Audit Impact Study*) (same). See also Colin Camerer & Richard H. Thaler, *Ultimatums, Dictators and Manners*, 9 J. ECON. PERSPECTIVES 209, 216-18 (1995), <https://www.aeaweb.org/articles?id=10.1257/jep.9.2.209> (observing that people seem to punish those who behave unfairly (*i.e.*, reciprocity) even when no future encounters are expected because they "have simply adopted rules of behavior they think apply to themselves and others, regardless of the situation" (*i.e.*, manners)).
- 19 See, *e.g.*, National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (*Most Serious Problem: IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*). For example, LB&I's "Key Stats" report contains 14 substantive worksheets. LB&I response to TAS information request (June 23, 2016). The first 12 worksheets contain detailed enforcement productivity statistics (*e.g.*, closures, dollars per hour, yield, hours per return, cycle time, no change rates, etc.) broken out by type of taxpayer, income level and issue (*i.e.*, activity code). *Id.* Only the last two worksheets are devoted to quality, customer and employee satisfaction, which are not broken out by activity code, and for the last few years have not been broken out by industry. *Id.* The report does not contain any behavioral response indicators such as measures of self-correction or future compliance.
- 20 GAO, GAO/GGD-96-109, *IRS Has Made Progress but Major Challenges Remain* 11 (June 1996), <http://www.gao.gov/assets/230/222671.pdf> ("about 63 percent of those [IRS officials] we [GAO] interviewed believed that this approach [Compliance 2000] will reduce the tax gap, and nearly 70 percent, who had knowledge of previous attempts, believed that it will be more cost effective."); National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 23 (1997), <http://www.house.gov/natcommirs/report1.pdf> ("The traditional enforcement approach ... [was not only] expensive, but it did not identify patterns of noncompliance. The new approach shifts emphasis to preventing noncompliance by identifying areas in which noncompliance is most likely to occur."). Similarly, traditional police enforcement is not as effective in reducing crime as working with community partners to address the underlying problems (called problem-oriented policing or POP). See, *e.g.*, David Weisburd et al., *Is Problem-Oriented Policing Effective in Reducing Crime and Disorder? Findings From a Campbell Systematic Review*, 9 CRIM. & PUB. POL. 139, 141 (2010), [http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd\\_et\\_al.pdf](http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd_et_al.pdf). Moreover, an excessive focus on reducing reported crimes, rather than on the means used, can lead to misreporting of crime, abuse of power, and a dysfunctional organizational culture. See, *e.g.*, Malcolm Sparrow, *Handcuffed, What Holds Policing Back, and the Keys to Reform* 20-22 (2016).
- 21 GAO, GAO/GGD-96-109, *IRS Has Made Progress but Major Challenges Remain* 11 (June 1996). By contrast, POP is still widely supported by local enforcement agencies and the U.S. Department of Justice (DOJ). POP goes hand in hand with community oriented policing, which is so successful that the DOJ Office of Community Oriented Policing Services (COPS) provides grants to facilitate its adoption. DOJ, Congressional Justification, *FY 2017 Performance Budget* (Feb. 9, 2016), <https://www.justice.gov/jmd/file/821491/download>.

The IRS replaced Compliance 2000 with Compliance Initiative Projects (CIPs).<sup>22</sup> CIPs enable exam to collaborate with other functions to implement alternative treatments,<sup>23</sup> but it uses them primarily to identify returns to examine.<sup>24</sup> If exam identifies an alternative treatment, the CIP process does not require anyone to pursue it.<sup>25</sup> Even if the IRS initiated an alternative treatment, it would not necessarily report on the results in connection with the CIP.<sup>26</sup> Rather, the IRS evaluates CIPs using exam productivity metrics (called “records of tax enforcement results” or ROTERS), such as dollars per hour, dollars per return, and the examination no-change rate.<sup>27</sup> It does not use RCTs or otherwise evaluate the impact of a CIP on taxpayer behavior (*e.g.*, self-correction or future compliance) or attitudes (*e.g.*, customer satisfaction with or trust for the agency).<sup>28</sup>

Large Business and International’s (LB&I’s) new “campaigns” may be similar to Compliance 2000 projects (or CIPs) because they can involve alternative treatments, but LB&I has not disclosed how it will identify appropriate treatments or the metrics it will use.<sup>29</sup> The Tax Exempt and Government Entities (TE/GE) Employee Plans Compliance Unit’s (EPCU) projects have similar features, but EPCU does not always report the revenue and compliance gains from alternative treatments in its project reports.<sup>30</sup>

22 See Internal Revenue Manual (IRM) 4.19.10.2.5 (Jan. 1, 2011).

23 IRM 4.17.1.4 (Feb. 25, 2010); IRM 4.17.4.4.1 (Feb. 25, 2010); Form 13498, *Compliance Initiative Project Authorization - Part Two* (Apr. 2009).

24 There may have been a few multifunctional CIPs, but they are not the norm. IRS response to TAS information request (June 22, 2016) (“SBSE Exam is not aware of any non-enforcement function working Compliance Initiative Projects.”); SB/SE response to TAS information request (Oct. 22, 2016) (“SBSE is still not aware of any non-enforcement functions working Compliance Initiative Projects.”); SB/SE response to TAS fact check (Nov. 21, 2016) (“During a cursory review of CIPs for this fact check request response, SB found two examples of multi-Functional CIPs ... We also have [six] examples where our Communication and Stakeholder Outreach function (CSO) [formerly known as Communication, Liaison, and Disclosure (CLD)] has worked with our Examination function on a CIP and signed off on the CIP”). Alternative treatments could be used in most CIPs. For example, the IRS could send soft notices and educational materials to all of the taxpayers with apparent discrepancies to give them an opportunity to self-correct so that an examination would not be necessary.

25 Only IRM parts 4 and 5, which apply to examination and collection employees, discuss the implementation of CIPs, and these IRMs do not direct enforcement employees to implement alternative treatments.

26 IRM Exhibit 4.17.2-1 (Feb. 25, 2010); Form 13497, *Compliance Initiative Project Authorization - Termination Report* (2008).

27 CIP analysts prepare and review monthly CIP data overview reports, which focus on ROTERS. IRM 4.17.2 (Feb. 25, 2010); IRM Exhibit 4.17.2-1 (Feb. 25, 2010). Similarly, the CIP Termination Report form asks for: number of returns examined, number of returns no-changed, number of returns surveyed, average time per return, average deficiency or adjustment (1120S, 1065), number of referrals to Criminal Investigation, and number of joint investigations from such referrals. IRS Form 13497, *Compliance Initiative Project Authorization - Termination Report* (2008).

28 *Id.*

29 See, *e.g.*, Dolores Gregory, *Corporate Taxes: LB&I to Focus on Audit Approach, Cultural Shift*, 008 DTR S-18 (Jan. 13, 2016) (a campaign “issue could be to initiate a number of audits, O’Donnell [LB&I Commissioner] told Bloomberg BNA in December. ‘But it could also be some other tailored treatment — specific guidance, change to a form, updated instructions — there are a host of things we could be doing ...’”); LB&I response to TAS information request (June 22, 2016) (“Campaign Metrics will be specific to each campaign. We are in the process of developing metrics for our approved campaigns. We have just approved four campaigns. We do not have results at this time.”). But, LB&I does not accurately track audit adjustments by issue so that it knows where taxpayers are making the most significant errors. See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-30-089, *The Large Business and International Division’s Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 14, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630089fr.pdf>.

30 See IRS, *EPCU - Completed Projects - Projects With Summary Reports* (June 13, 2016), <https://www.irs.gov/retirement-plans/employee-plans-compliance-unit-epcu-completed-projects-projects-with-summary-reports>.

### Alternative Treatments That Use Behavioral Insights Can Have a Significant and Measurable Return on Investment (ROI)

Small changes or “nudges” can remove barriers that impede public policy goals, such as hard-to-understand information, burdensome forms, or poorly presented choices.<sup>31</sup> For example, financial aid applications pre-filled with information from tax returns can significantly increase qualifying applications and college attendance, even though there are already significant economic incentives for filling out the application and going to college.<sup>32</sup> Because the government designs tax rules, procedures, and communications that create or minimize such barriers, it cannot avoid nudging taxpayers in one direction or another.

In 2010, the United Kingdom (U.K.) government created the Behavioural Insights Team (BIT or the “Nudge Unit”) to help various government agencies apply BIs, including Her Majesty’s Revenue and Customs (HMRC), the U.K. tax agency. It focused on BIs described using the acronym MINDSPACE:<sup>33</sup>

- Messenger – we are heavily influenced by who communicates information;
- Incentives – our responses to incentives are shaped by predictable mental shortcuts such as strongly avoiding losses (rather than cost benefit computations);
- Norms – we are strongly influenced by what others do;
- Defaults – we ‘go with the flow’ of pre-set options;<sup>34</sup>
- Salience – our attention is drawn to what is novel and relevant to us;
- Priming – our acts are often influenced by sub-conscious cues;
- Affect – our emotional associations can powerfully shape our actions;
- Commitments – we seek to be consistent with our public promises, and reciprocate acts; and
- Ego – we act in ways that make us feel better about ourselves.<sup>35</sup>

31 See, e.g., Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449 (2003); Richard H. Thaler & Cass R. Sunstein, *NUDGE* (2008); Christine Jolls, Cass R. Sunstein, & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998).

32 Eric P. Bettinger et al., *The Role of Application Assistance and Information in College Decisions: Results from the H&R Block FAFSA Experiment*, 127 Q. J. ECON. 1205 (2012).

33 David Halpern, *Inside the Nudge Unit, How Small Changes Can Make A Big Difference* 50 (2015). MINDSPACE was later replaced by EAST, which means: Easy, Attractive, Social, and Timely. *Id.* at 60 and 149. For further discussion of the insights, see, e.g., BIT, *Applying Behavioural Insights to Reduce Fraud, Error and Debt* 4 (2012); Laura Haynes et al., Cabinet Office, BIT, *Test, Learn, Adapt: Developing Public Policy with Randomized Controlled Trials* (2012), [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/62529/TLA-1906126.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/62529/TLA-1906126.pdf).

34 For example, filing and reporting compliance might increase in the U.S. if taxpayers (and preparers) could easily download into their tax software the third-party information return data needed to prepare returns, as recommended by the National Taxpayer Advocate. National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 68, 79 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

35 BIT also found that treatments were more effective for taxpayers with a history of compliance. David Halpern, *INSIDE THE NUDGE UNIT, HOW SMALL CHANGES CAN MAKE A BIG DIFFERENCE* 131 (2015). Thus, spending extra resources to help first-time taxpayers and startups establish good tax compliance habits could help avoid the need to spend more resources to address noncompliance after bad habits develop.



Tax agencies have been using RCTs and field experiments to measure the effectiveness of various alternative treatments using BIs, as described below:<sup>36</sup>

- HMRC and the Australian Office of State Revenue (OSR) revised tax delinquency letters to include norms statements such as “9 out of 10 UK citizens pay their self-assessment tax on time,” while increasing the clarity and salience of the letters.<sup>37</sup> The most successful message led to a five percentage point increase in payments in the U.K. and a three point increase in Australia, as compared to the standard notice.<sup>38</sup>
  - HMRC found tailored messages, which increased the salience of the delinquency letters for a specific population (*e.g.*, doctors), increased the response rate from 3.8 percent to 35.3 percent.<sup>39</sup>
  - By sending taxpayers directly to a form, rather than a webpage that contained the form, HMRC increased the response to delinquency notices by four percentage points.<sup>40</sup>
- The U.S. Treasury’s Debt Management Service (DMS) prompted about 45 percent more individuals to pay online (from 1.5 to about 2.2 percent) by shortening the web address.<sup>41</sup>

36 See, *e.g.*, Laura Haynes *et al.*, Cabinet Office, BIT, *Test, Learn, Adapt: Developing Public Policy with Randomized Controlled Trials*, Policy Paper, (2012); World Bank, *Mind Society and Behavior* 198 (2015). <http://www.worldbank.org/content/dam/Worldbank/Publications/WDR/WDR%202015/WDR-2015-Full-Report.pdf>; BIT, *Applying Behavioural Insights to Reduce Fraud, Error and Debt* (2012), [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/60539/BIT\\_FraudErrorDebt\\_accessible.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/60539/BIT_FraudErrorDebt_accessible.pdf); Joana Sousa Lourenço *et al.*, *Behavioural Insights Applied to Policy*, European Report 2016, EUR 27726 (2016), [http://publications.jrc.ec.europa.eu/repository/bitstream/JRC100146/kjna27726enn\\_new.pdf](http://publications.jrc.ec.europa.eu/repository/bitstream/JRC100146/kjna27726enn_new.pdf).

37 See Michael Hallsworth, *The Behavioralist As Tax Collector: Using Natural Field Experiments to Enhance Tax Compliance* (NBER Working Paper No. 20007, 2014), <http://www.nber.org/papers/w20007>; Premier & Cabinet Behavioural Insights Unit, *Understanding People, Better Outcomes: Behavioural Insights in NSW* (Oct. 2014), <http://bi.dpc.nsw.gov.au/assets/Behavioural-Insights/Library/Understanding-People-Better-Outcomes.pdf>. See also BIT, *Update Report 2013-2015*, 55 n.1 (2015) (referencing House of Lords, *Science and Technology Select Committee on Behaviour Change* (Nov. 2010), <http://www.parliament.uk/documents/lords-committees/science-technology/behaviourchange/BCOralandWrittenEvCompiled180711.pdf>); David Halpern, *INSIDE THE NUDGE UNIT, HOW SMALL CHANGES CAN MAKE A BIG DIFFERENCE* 113-15 (2015).

38 BIT, *EAST, Four Simple Ways to Apply Behavioural Insights* 5 (July 2015), [http://www.behaviouralinsights.co.uk/wp-content/uploads/2015/07/BIT-Publication-EAST\\_FA\\_WEB.pdf](http://www.behaviouralinsights.co.uk/wp-content/uploads/2015/07/BIT-Publication-EAST_FA_WEB.pdf); Premier & Cabinet Behavioural Insights Unit, *Understanding People, Better Outcomes Behavioural Insights in NSW* 4-5 (Oct. 2014).

39 BIT, *EAST, Four Simple Ways to Apply Behavioural Insights* 23 (July 2015). See also David Halpern, *INSIDE THE NUDGE UNIT, HOW SMALL CHANGES CAN MAKE A BIG DIFFERENCE* 88 (2015). A similar approach worked with other professionals such as plumbers. *Id.*

40 David Halpern, *INSIDE THE NUDGE UNIT, HOW SMALL CHANGES CAN MAKE A BIG DIFFERENCE* 74 n.10 (2015) (citing an increase from 19.2 to 23.4 percent); BIT, *EAST, Four Simple Ways to Apply Behavioural Insights* 12 (July 2015), [http://www.behaviouralinsights.co.uk/wp-content/uploads/2015/07/BIT-Publication-EAST\\_FA\\_WEB.pdf](http://www.behaviouralinsights.co.uk/wp-content/uploads/2015/07/BIT-Publication-EAST_FA_WEB.pdf).

41 Fact Sheet: President Obama Signs Executive Order; White House Announces New Steps to Improve Federal Programs by Leveraging Research Insights (Sept. 15, 2015), <https://www.whitehouse.gov/the-press-office/2015/09/15/fact-sheet-president-obama-signs-executive-order-white-house-announces>. In 2014, the White House Office of Science and Technology Policy (OSTP) established the Social and Behavioral Sciences Team (SBST), a cross-agency team organized under the National Science and Technology Council to identify how behavioral insights could help U.S. agencies. Nat’l Sci. & Tech. Council, Exec. Off. of the President, Soc. & Behav. Sci. Team (SBST), *2015 Annual Report* (Sept. 2015), [https://www.whitehouse.gov/sites/default/files/microsites/ostp/sbst\\_2015\\_annual\\_report\\_final\\_9\\_14\\_15.pdf](https://www.whitehouse.gov/sites/default/files/microsites/ostp/sbst_2015_annual_report_final_9_14_15.pdf). SBST worked with Treasury on this project.

- The National Tax Agency of Colombia (DIAN) increased the probability of payment by eight percentage points with a letter, 17 points with an email, and about 87 points with a personal visit, which in each case delivered the same deterrence and moral suasion messages.<sup>42</sup>
- The Guatemalan tax authority tested social norms and deliberate choice messages in its delinquency letters. These messages increased the average amount paid per taxpayer by 210 percent and 269 percent, respectively, relative to no letter.<sup>43</sup> The deliberate choice message stated: *“Previously we have considered your failure to declare an oversight. However, if you don’t declare now we will consider it an active choice and you may therefore be audited and could face the procedure established by law.”* The ROI for the social norms and deliberate choice letters was about 35 to 1.<sup>44</sup> They also increased the likelihood that taxpayers would both declare and pay the following year with no further reminder.

Although reporting compliance may be more difficult to measure, both norms- and deterrence-based messages can also increase reporting compliance by measurable amounts, particularly if carefully tailored. For example, a 2007 study found that letters with normative appeals (*“most people in this country pay ... [and mistakes mean] less money available for public spending on things like hospitals, schools and pensions”*) and deterrence messages (the agency is increasing inquiries and *“your return may be one of those chosen”*) both prompted small businesses in the U.K. to increase reported sales (above the simplified reporting threshold) and net profits.<sup>45</sup>

42 Daniel Ortega and Carlos Scartascini, *Don’t Blame the Messenger: A Field Experiment on Delivery Methods For Increasing Tax Compliance* 31 (CAF, Development Bank of Latin America, Working Paper No. 2015/09, 2015), <http://scioteca.caf.com/handle/123456789/821>. The authors suggest email may have been superior to letters because “[T]he agency had been moving many of its transactions online, so the email may have had a relatively higher salience, which may not export easily to other places. Additionally, given the fact that payments can be made online, the act of paying may have been more spontaneous than after receiving a letter (the person was already sitting at the computer).” *Id.* at 27 n31. Another study by the same researchers found that phone calls have an intermediate effect between the impersonal methods and in-person visits. *Id.* at 3 (citing Daniel Ortega & Carlos Scartascini, Inter-American Development Bank, *Who’s Calling? The Effect of Phone Calls as a Deterrence Mechanism* (2015)).

43 Stewart Kettle et al., *Behavioural Interventions in Tax Compliance: Evidence from Guatemala*, IRS Research Conference (2015), <https://www.irs.gov/pub/irs-soi/15resconhemanandez.pdf>. The authors explain the deliberate choice message “aims to eliminate omission as an excuse for noncompliance now ... The wording also gives the taxpayer an exemption for not previously declaring, which introduces an element of reciprocity, as the taxpayer is given the sense that he has been granted a favor. The text is also worded to give the impression that the behaviour of the taxpayer is being closely monitored and serves to increase the perception of punishment for noncompliance.” *Id.* at 148.

44 *Id.* at 157-58.

45 See John Hasseldine et al., *Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors*, 24 CONTEMP. ACCOUNTING RES. 171-94 (Spring 2007), <http://onlinelibrary.wiley.com/doi/10.1506/P207-004L-4205-7NX0/abstract>. These findings are generally consistent with prior research. See Joel Slemrod et al., *Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Field Experiment in Minnesota*, 79 J. PUB. ECON. 455-83 (2000) (finding a letter emphasizing “increased audit” probability increased reporting compliance for low income Schedule C or F filers, but reduced it for high income taxpayers), and Richard Schwartz & Sonya Orleans, *On Legal Sanctions*, 34 UNIV. CHICAGO L. REV. 274, 299 (1967) (finding taxpayers who had been asked survey questions that either appealed to conscience or that highlighted sanctions both increased their reporting compliance, though the effect of the sanction discussion was weaker). *But see*, Marsha Blumenthal et al., *Do Normative Appeals Affect Tax Compliance? Evidence From a Controlled Experiment in Minnesota*, 54 NAT. TAX J. 125-36 (2001) (finding a generic letter which said “[a]udits ... [show people] pay voluntarily 93 percent” of what they owe (a normative appeal) did not improve reporting compliance by Schedule C or F filers; however, the letter stated that “many Minnesotans believe other people routinely cheat” and recipients may not have believed that audits detected all noncompliance).

Improving the timing and salience of existing messages can also improve reporting compliance.<sup>46</sup> For example, the General Services Administration (GSA) improved the accuracy of government contractors' self-reported sales by moving an online signature box from the bottom to the top of the form, enabling GSA to collect an additional \$1.59 million in fees in a single quarter.<sup>47</sup>

### Alternative Treatments That Ignore Behavioral Science Insights Can Be Ineffective

In February 2009, Wage and Investment's (W&I) Stakeholder Partnerships, Education and Communication function (SPEC) sent a brochure of "common errors" to elderly taxpayers who had a math error on their 2007 returns.<sup>48</sup> The brochures generally did not improve compliance.<sup>49</sup> However, seniors are less responsive than others to impersonal forms of communication.<sup>50</sup> More importantly, the brochure did not remind the recipient that he or she had made an error, which would have increased its salience. For those who read the brochure, its reference to "common errors" reinforced the view that making errors is the norm for seniors — a message that is, potentially, more likely to reduce compliance than improve it. Moreover, it may be particularly difficult to avoid repeating inadvertent errors.

Of course, it would be inaccurate to conclude that all alternative treatments are ineffective because one did not provoke the desired behavior in a specific context with a specific population. Rather, the IRS needs to measure and report on the effectiveness of specific alternative treatments with different populations on a regular basis so that it can better understand why some are more effective than others for a particular segment. If one IRS function identifies an effective alternative treatment, it should publish and index the results so that other functions and stakeholders can benefit.

### The IRS Is Testing Alternative Treatments That Use Behavioral Insights

Preliminary data suggests the W&I Division has improved reporting compliance by sending "soft" notices to taxpayers who appeared (based on third-party reporting) to have violated the Individual Retirement Account (IRA) contribution and distribution rules during 2013-2015.<sup>51</sup> These notices appear to have educated taxpayers, making compliance easier and noncompliance more salient and visible. In some cases, W&I did not use a randomly selected control group.<sup>52</sup> However, its (non-projectable) results indicate that "approximately 91 percent of notice recipients and 85 percent of non-notice recipients stopped contributing in excess ..." and "roughly 10 percent of notice recipients self-assessed the excise tax [penalty] in comparison to non-notice recipients whose correction rate remained at 1 percent."<sup>53</sup>

46 See, e.g., Lisa L. Shu et al., *Signing at the Beginning Makes Ethics Salient and Decreases Dishonest Self-Reports in Comparison to Signing at the End*, 109 PROC. NAT'L ACAD. SCI. 15197 (2012), <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3458378/> (finding that signing before — rather than after — the opportunity to cheat makes ethics salient at the right time, and significantly reduces dishonesty).

47 Nat'l Sci. & Tech. Council, Exec. Off. of the President, *SBST, 2015 Annual Report* (Sept. 2015), <https://sbst.gov/>.

48 WIRA, Project No: 4-09-01-S-006, *SPEC's Senior Math Error Direct Mail Marketing Campaign* (Jan. 2010).

49 *Id.*

50 IRS, Pub. 4579, *Taxpayer Assistance Blueprint Phase II* 65 (2007), <http://www.irs.gov/pub/irs-pdf/p4579.pdf> (Figure 3-7). Further, the study does not indicate that the IRS removed taxpayers from the analysis if their brochures were returned as undeliverable. WIRA, Project No: 4-09-01-S-006, *SPEC's Senior Math Error Direct Mail Marketing Campaign* (Jan. 2010).

51 Wage and Investment (W&I) response to TAS information request (June 22, 2016). Both GAO and TIGTA had identified IRA compliance as a problem. See TIGTA, Ref. No. 2008-40-087, *Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance* (Mar. 28, 2008); GAO, GAO-08-654, *Individual Retirement Accounts: Additional IRS Actions Could Help Taxpayers Facing Challenges in Complying with Key Tax Rules* (Aug. 14, 2008); TIGTA, 2010-40-043, *A Service-wide Strategy Is Needed to Address Growing Noncompliance With Individual Retirement Account Contribution and Distribution Requirements* (Mar. 29, 2010).

52 W&I response to TAS information request (June 22, 2016).

53 W&I Strategies and Solutions Group 3, Project Num. 4-15-03-S-616, *Excess Contributions to Individual Retirement Accounts: 2014 Mail-Out Analysis 3* (June 2016).



In July 2016, the IRS reported on several ongoing EITC studies mandated by Congress.<sup>54</sup> In one, the IRS reduced the EITC errors that preparers made on returns, by visiting, calling, and sending notices.<sup>55</sup> Mode of communication mattered. In-person visits were more effective, but also more costly. Salience and relevance mattered. Notices that specified the types of errors the IRS was seeing were more effective than generic notices. Timing also mattered. The IRS had more success when it sent notices immediately before the filing season than during the filing season.

In a second study, the IRS improved EITC reporting compliance by working with tax software companies to clarify eligibility questions, and require taxpayers to affirm key facts. This made eligibility easier to determine. It probably also made it harder for taxpayers to justify noncompliance while retaining a positive self-image (*e.g.*, on the basis that the rules were complicated and they did not understand).

In a third study, the IRS sent letters to those with apparent discrepancies, explaining the discrepancy, and asking them to self-correct, if necessary. These letters should also make it easier for taxpayers to comply and harder for them to justify noncompliance.

In fiscal years (FYs) 2013 to 2015, the IRS sent reminders to low income taxpayers who appeared eligible for the EITC, but had not filed a return.<sup>56</sup> The reminders reduced nonfiling for the year in question (and prior years) for both taxpayers with a balance due and those due a refund (*i.e.*, addressing inattentiveness).<sup>57</sup> They also increased voluntary compliance in subsequent years, at least for those who had received a refund. The reminders might have been even more effective if they had explained why the IRS believed the taxpayer should have filed (increasing salience). Researchers projected that an expansion of the effort could bring in an additional 53,000 filers, pay out \$180 million in additional refunds, and bring in an additional \$27 million in unpaid taxes.<sup>58</sup> However, the IRS did not report any of the foregoing “service” revenues to stakeholders in its routine reports.<sup>59</sup>

Similarly, in January 2016, TAS sent letters to taxpayers who claimed the EITC on 2014 returns that were not audited even though the returns appeared to have the same problems as those that were. The letter was salient, highlighting that the purpose was “so that you can avoid an error in the future,” explaining the requirements for claiming the EITC in easy to understand language, identifying the exact requirement that the taxpayer did not appear to meet and why, and suggesting sources of additional information and

54 U.S. Department of the Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis* 16 (July 5, 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-EITC-Data-Driven-Compliance-2016.pdf>.

55 For additional information, see, Karen Masken, *IRS Preparer-Level Treatment Tests* (Dec. 2014), <https://www.irs.gov/pub/irs-soi/15resconmasken.pdf>.

56 IRS response to fact check (Dec. 7, 2016); IRS Management’s Discussion & Analysis (MD&A) 5-6 (FY 2015), reproduced in, GAO, GAO-16-146, *Financial Audit: IRS’s Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015), [www.gao.gov/assets/680/673614.pdf](http://www.gao.gov/assets/680/673614.pdf); RAAS response to TAS information request (July 7, 2016).

57 Researchers found no difference when the reminder was framed to harness loss aversion (*i.e.*, “avoid losing valuable tax benefits”). RAAS response to TAS information request (July 7, 2016).

58 *Id.*

59 Compare IRS MD&A FY 2015, *supra* 5-6 (not referencing service revenue estimates), with U.S. Department of the Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis* 16 (July 5, 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-EITC-Data-Driven-Compliance-2016.pdf> (indicating the study would quantify the results in October 2016) and John Guyton *et al.*, *Reminders & Recidivism: Evidence From Tax Filing & EITC Participation Among Low-Income Nonfilers* § IV(b)(2) (NBER Working Paper 21904, 2016), <http://www.nber.org/papers/w21904.pdf> (reporting that “roughly 52% of individuals who had a balance due on the 2013 return recidivated into nonfiling, but the treatment reduced this recidivism to about 42%”).

assistance, including TAS.<sup>60</sup> TAS also considered timing, mailing the letters in the second or third week of January when taxpayers might expect to get tax-related notices, such as W-2's, and noted on the outside of the envelope "important tax information enclosed." These letters improved compliance for some types of recipients as compared to the control group that did not receive a letter, as discussed in volume 2 of this report.<sup>61</sup>

Small Business/Self-Employed (SB/SE) is also working to improve the "alerts" it provides to taxpayers at risk of falling behind on their federal tax deposits (called FTD alerts).<sup>62</sup> It is using BIs related to (1) timing – triggering them earlier, sometimes before a deposit is due; (2) salience and visibility – better targeting taxpayers most likely to fall behind, and explaining why they are receiving a reminder; (3) social norms – including statements like "nine out of ten businesses deposit on time each quarter;" (4) rational appeals or deterrence – disclosing the penalties and interest that could apply, and (5) segmentation – using different modes of communication (*e.g.*, letters, calls, and visits) for different segments.<sup>63</sup>

In addition, SB/SE is sending notices to taxpayers who appear to be under withheld.<sup>64</sup> The notices include rational appeals about the potential consequences of being under withheld (*i.e.*, deterrence), but do not explain why the IRS believes there is a problem.<sup>65</sup> Similarly, the IRS is testing the extent to which sending additional letters to non-filers before it makes substitute for return (SFR) assessments triggers self-correction.<sup>66</sup> While these letters may improve voluntary compliance, the IRS should incorporate BIs to improve the results and report the resulting revenue and compliance gains.

Finally, TAS is investigating the effectiveness of letters that use BIs to improve payment compliance.<sup>67</sup> These letters may include: (1) rational appeals – information on the composition of the outstanding amount and the accrual of interest and penalties; (2) social norms appeals – information about the high rate of on-time tax payments in the taxpayers' area; (3) reciprocity appeals – information on how payments are used for services that benefit taxpayers; (4) threats of enforcement – information on potential penalties and the IRS's capacity to enforce noncompliant behavior; and (5) "extra help" offers – the telephone number of a hotline staffed with TAS employees who will assist with the filing and payment process (including payment alternatives). TAS will also compare the impact of different letter formats, such as those using a typical IRS format and those formatted using cognitive and visual learning concepts. TAS plans to quantify and report the overall and relative effectiveness of each communication. However, it is unclear whether or how the IRS will report any "service" revenues that result from these letters or its other BI projects (discussed above) to stakeholders.

60 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 184 (TAS Research Initiatives: *Impact of Education and Outreach on Earned Income Tax Credit (EITC) Taxpayer Compliance*).

61 Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter from the National Taxpayer Advocate*, vol. 2, *supra*.

62 SB/SE response to TAS information request (June 22, 2016).

63 *Id.* Through FY 16 (April), over 85 percent of FTD Alerts were worked in the field, and Field Time overall (all cases in Field Collection), increased by nearly 12 percent compared to last year. SB/SE response to fact check (Dec. 8, 2016). This could improve the salience of the message. The IRS also found that letters increase payments for certain taxpayer segments. *Id.* Although personal contacts are likely superior, letters can nearly always be improved.

64 *Id.* Letter 2802C, *Withholding Compliance Letter*. SB/SE is also working to modify delinquency notices, such as CP 14, and to measure taxpayer responses to different versions using RCTs. SB/SE response to TAS information request (Oct. 19, 2016).

65 *Id.*

66 SB/SE response to TAS information request (June 22, 2016).

67 National Taxpayer Advocate 2017 Objectives Report to Congress 184.

### The IRS Reports “Enforcement” Revenues to Stakeholders More Routinely Than “Service” Revenue From Alternative Treatments, Potentially Biasing Policy Decisions

The IRS reports the revenues from alternative treatments on an *ad hoc* basis (*e.g.*, in connection with studies that it decides to publish), but routinely reports its “enforcement revenue” to stakeholders.<sup>68</sup>

“Enforcement” revenue generally include any payments received after a case is assigned to an “enforcement” function (*i.e.*, Exam, Appeals, Chief Counsel, Collection, Information Reporter Program (IRP), and the Automated Underreporter (AUR) Program), even if the taxpayers made them as a result of alternative treatments (*e.g.*, a letter) rather than an enforcement action (*e.g.*, an assessment or levy).<sup>69</sup> The IRS’s expansive definition of “enforcement” revenue exaggerates the effectiveness of coercive treatments, and seems to ignore “service” revenue.

More importantly, the IRS is working to quantify the ratio of direct “enforcement” revenue to cost for each of its “enforcement” programs so that it can allocate more resources to those with the greatest marginal ROI.<sup>70</sup> Similarly, the IRS routinely estimates “enforcement” ROIs to justify additional investments by “enforcement” functions, but not to justify additional investment by service functions.<sup>71</sup> Moreover, its “enforcement” revenue computations ignore the indirect effects of enforcement on voluntary compliance (*e.g.*, effects on future compliance or compliance by others).<sup>72</sup> The IRS plans to add

... indirect effects whenever we have reasonable estimates. There is no timeline established at this time. In the meantime, the resource allocation will continue to account for indirect effects by imposing minimum coverage constraints in each Exam category.<sup>73</sup>

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- 68 See, *e.g.*, IRS, *Fiscal Year 2015 Enforcement and Service Results* (Mar. 8, 2016), <https://www.irs.gov/uac/newsroom/fiscal-year-2015-enforcement-and-service-results>. As noted above, the IRS recently collaborated with outside researchers on four studies addressing various ways to improve EITC compliance, and quantified some of its results. See U.S. Department of Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis* 16 (July 5, 2016). However, the IRS mixed the results of alternative treatments with “enforcement revenue” in its routine reports. See IRS MD&A FY 2015, 44.
- 69 LB&I, Operations Planning & Support (OPS), *What Exactly Do We Mean by “Enforcement Revenue”?* (2016); Bill Gammon & Peter Rose, IRS, *Tracking and Estimating the Direct Revenue Effects of IRS Enforcement Actions* (Apr. 25, 2005). For a historic discussion of this problem, see IRS, Pub. 1501, *Evaluation of the IRS System of Projecting Enforcement Revenue* (Oct. 1990). Although the criminal investigation (CI) division is the only function that conducts true law enforcement, it is not considered an enforcement function for this purpose. *Id.*
- 70 The IRS is implementing a recommendation by GAO, which suggested the IRS should compute the direct marginal “enforcement” revenue ROI for its reporting compliance programs (*i.e.*, automated substitute for return, AUR, correspondence exam, and field exam) by broad taxpayer segments and allocate compliance resources on that basis. GAO, GAO-13-151, *IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* (Dec. 2012), <http://www.gao.gov/assets/660/650521.pdf>; RAAS, *Business Performance Review* (2014), <http://ras.web.irs.gov/AboutRAS/BPR/RASBPRJulSep2014.pdf>.
- 71 See, *e.g.*, IRS, *Budget in Brief* 10-15 (FY 2017), [https://www.treasury.gov/about/budget-performance/budget-in-brief/Pages/index\\_17.aspx](https://www.treasury.gov/about/budget-performance/budget-in-brief/Pages/index_17.aspx).
- 72 Ronald H. Hodge II et al., *Estimating Marginal Revenue/Cost Curves for Correspondence Audits*, IRS Research Conference 1 n.5 (2015), <https://www.irs.gov/pub/irs-soi/15resconplumley.pdf> (“If we had estimates of the associated changes in voluntary compliance that are induced indirectly by that program [some of the major discretionary categories of correspondence audits] throughout the entire population, those estimates could be added to the direct revenue estimates to represent the full benefit of the program.”); Alan H. Plumley & C. Eugene Steuerle, *Ultimate Objectives for the IRS: Balancing Revenue and Service*, in *THE CRISIS IN TAX ADMINISTRATION* 311, 329 (Henry J. Aaron & Joel Slemrod, eds., 2004), [http://webarchive.urban.org/UploadedPDF/1000636\\_IRS\\_objectives.pdf](http://webarchive.urban.org/UploadedPDF/1000636_IRS_objectives.pdf) (“The appeal of direct revenue maximization is that, for the most part, it is measurable, and it provides a basis for making resource allocation decisions ... To the extent that IRS activities — whether enforcement or nonenforcement — indirectly affect the voluntary compliance of the general population, it is the combination of direct and indirect revenue that is important.”); IRS, *Budget in Brief* 15 (FY 2017) (“[T]he ROI estimate does not include the revenue effect of the indirect deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.” [On average]).
- 73 RAAS response to TAS information request (July 7, 2016).

If the IRS could collect one percent more revenue through an unresponsive automated enforcement strategy that causes taxpayers to lose faith in the IRS and reduces voluntary compliance by one percent, voluntary compliance revenue would decline by about 60 times as much as “enforcement” revenue increased.

The IRS’s minimum coverage strategy is based on the implicit assumption that indirect effects are always positive and driven primarily by deterrence. However, research (discussed above) suggests the indirect effects could be negative, especially when coercion is misapplied to certain taxpayer segments.

If the IRS could collect one percent more revenue through an unresponsive automated enforcement strategy that causes taxpayers to lose faith in the IRS and reduces voluntary compliance by one percent, voluntary compliance revenue would decline by about 60 times as much as “enforcement” revenue increased.<sup>74</sup> Thus, if the IRS allocates resources to increase marginal “enforcement” revenue without regard to indirect effects, it risks making costly and ill-informed resource allocation decisions.<sup>75</sup> Alternative treatments are less likely to have negative indirect effects on voluntary compliance than enforcement treatments, as discussed above. Yet, the IRS does not routinely measure and report the direct (or indirect) revenue from alternative treatments.

## CONCLUSION

Alternative treatments can be a cost effective way to improve tax compliance while minimizing taxpayer burden, particularly if they use BIs. They also support taxpayer rights.<sup>76</sup> They help alert taxpayers when they may not have complied, promoting the *right to be informed*. They are less intrusive than coercive treatments, furthering the taxpayers’ *right to privacy*. They help taxpayers comply more quickly, promoting the taxpayers’ *right to finality*. Because coercing those who would respond to nudges seems unfair, they also support the taxpayer’s right to a *fair and just tax system*. Because the IRS can over-reach when using coercive tools, they also further the taxpayer right to *pay no more than the correct amount of tax*.

Unless the IRS identifies the best alternative treatments, such as those that leverage BIs, it is more likely to conclude that alternative treatments are ineffective. It should continue to test the effectiveness of different levers with different taxpayer segments using RCTs. Even if the IRS identifies effective alternative treatments, it may underutilize them unless it routinely quantifies and reports the resulting service revenues and compliance gains.

74 See GAO, GAO-16-146, *Financial Audit: IRS’s Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015), [www.gao.gov/assets/680/673614.pdf](http://www.gao.gov/assets/680/673614.pdf) (reflecting direct “enforcement” revenue of \$54.2 billion out of \$3.3 trillion). The indirect effect of IRS activities on compliance far exceeds the direct effects, with the indirect effect of an audit exceeding six times the proposed assessment, according to some IRS estimates. See, e.g., Alan H. Plumley, *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results*, National Tax Association, 95th Annual Conference on Taxation 12-13 (2002), <http://www.irs.gov/pub/irs-soi/irsvtc.pdf>; Jeffrey A. Dubin et al., *The Effect of Audit Rates on the Federal Individual Income Tax, 1977-1986*, 43 Nat. Tax J. 395, 405 (1990), <http://www.ntanet.org/NTJ/43/4/ntj-v43n04p395-409-effect-audit-rates-federal.pdf>. Without effective and timely measures of voluntary compliance, any negative indirect effects from more “efficient” exams will go unnoticed.

75 See, e.g., Treasury Department, *Congressional Justification* 112 (FY 2017), <http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx>. (“Net revenue is maximized only when resources are allocated according to marginal *direct and indirect* return on investment, but those ratios are much more challenging to estimate than the average ROI shown here.”).

76 See IRC § 7803(a); TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt procedures for routinely testing BIs using RCTs to identify which ones are most effective for various compliance problems and taxpayer segments.
2. Adopt procedures to timely disclose the results of IRS studies and RCTs so that all internal and external stakeholders can benefit from them.
3. Routinely measure and report the “service” revenue and compliance gains from alternative treatments to internal and external stakeholders.
4. Discontinue or modify reports that highlight “enforcement” revenue (as currently defined), which is misleading because it includes “service” revenue and does not include the (potentially negative) indirect effects of unnecessary coercion.
5. Incorporate behavioral response metrics (*e.g.*, response rates and future compliance) into all IRS programs to help avoid over-emphasizing the importance of direct revenue.

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#2**WORLDWIDE TAXPAYER SERVICE: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges As Other Tax Administrations****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Operating Division

Paul Mamo, Director, Office of Online Services

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

Jeffrey Tribiano, Deputy Commissioner, Operations Support

**TAXPAYER RIGHT IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*

**DEFINITION OF PROBLEM<sup>2</sup>**

The IRS, like tax administrations elsewhere, has reacted to budgetary constraints in recent years by shifting taxpayer services to online channels.<sup>3</sup> “Best practices” in taxpayer service begin with considering taxpayers’, as opposed to the tax administration’s, needs and preferences, but the IRS bases its approach on information and surveys that are not designed to elicit diverse taxpayer perspectives and do not distinguish between simple tasks and highly emotional, complex transactions. The IRS’s vision of how taxpayers will interact with it through their online accounts may be unrealistic, conveying to taxpayers a lack of interest in engaging with them.

**ANALYSIS OF PROBLEM****Background**

In the light of a budget cut of about 19 percent from fiscal year (FY) 2010 to FY 2016, the IRS, as an integral part of its “Future State” design, plans significant shifts to online channels, particularly online taxpayer accounts, to deliver taxpayer service.<sup>4</sup> The IRS is not the only tax administration confronted with a shrinking budget in recent years. According to the Organisation for Economic Co-operation and

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Taxpayer Service in Other Countries*, vol. 3, *infra*.
- 3 National Taxpayer Advocate 2015 Annual Report to Congress 3 (Most Serious Problem: *The IRS Has Developed a Comprehensive “Future State” Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*); Organisation for Economic Co-operation and Development (OECD), *Managing Service Demand: A Practical Guide to Help Revenue Bodies Better Meet Taxpayers’ Service Expectations* 9 (2013).
- 4 “Future State” refers to the IRS’s description of how it intends to operate in coming years. For a full discussion of the IRS’s “Future State,” see National Taxpayer Advocate 2015 Annual Report to Congress 3 (Most Serious Problem: *The IRS Has Developed a Comprehensive “Future State” Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*); Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.



Applying these insights to tax administration, if a taxpayer prefers telephone or in-person communication and that channel is not available, the taxpayer may feel alienated, frustrated, and disengaged from the tax system. He may make an emotional decision that he will regret later, such as ignoring the IRS's messages or agreeing to the IRS's adjustments to his return even though he believes the IRS is wrong.

Development (OECD), out of 56 countries surveyed, 21 reported that specific reductions in their tax administrations had been required.<sup>5</sup>

In response to financial pressures, many tax administrations, like the IRS, adopted the objective of shifting taxpayer service to self-service and online channels.<sup>6</sup> As of 2011, however, efforts for managing service demand were “immature — fragmented, incomplete, and/or lacking co-ordination” and revenue bodies were not effectively determining the root cause of demand for various services and service channels.<sup>7</sup>

This situation has persisted, with revenue bodies seeking to increase the use of online channels but not collecting enough data to understand what services taxpayers seek via online channels and the reasons taxpayers choose to use online services.<sup>8</sup> The IRS, for example, has appeared to view online accounts as a substitute for, rather than a complement to, other service channels such as telephone or in-person assistance.<sup>9</sup> This approach is inconsistent with at least one non-IRS survey showing that people who interacted with various federal government administrations had a slightly higher level of satisfaction with their in-person interactions than with digital interactions through mobile applications, federal websites, and email.<sup>10</sup>

### **Taxpayers Overall Prefer a Mix of Channels, and the Delivery Channel an Individual Taxpayer Prefers May Depend on the Services Being Sought and Whether the Transaction Is Emotionally Charged**

Experience elsewhere in the world demonstrates that, as in the United States, when citizens interact with their governments they prefer different service channels depending on the task they hope to accomplish.<sup>11</sup> For example, a case study of how 500 job seekers would prefer to use the services of the German Federal Employment Agency showed they usually preferred online services to search for a job, telephone services for making appointments and contacting employers, and in-person contact for signing up for employment, unemployment benefits, or counseling.<sup>12</sup> Even the 215 citizens in the study who were daily internet users did not prefer digital delivery for all services — these users also preferred multiple channels,

5 OECD, *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies* 171-72, Table 5.1 (2015). These countries are: Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Mexico, Netherlands, New Zealand, Portugal, Slovenia, Spain, United Kingdom, and United States (OECD countries); Cyprus, Romania, and Russia (non-OECD countries).

6 See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*, *infra*.

7 OECD, *Managing Service Demand: A Practical Guide to Help Revenue Bodies Better Meet Taxpayers' Service Expectations* 9 (2013).

8 OECD, *Increasing Taxpayers' Use of Self-Service Channels* 28-32, 65 (2014).

9 National Taxpayer Advocate 2015 Annual Report to Congress 7 (Most Serious Problem: *The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*) (noting that “[b]ased on our internal discussions with IRS officials, TAS has been left with the distinct impression that the IRS’s ultimate goal is ‘to get out of the business of talking with taxpayers.’”).

10 See Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience* 2 (Feb. 18, 2016).

11 National Taxpayer Advocate 2015 Annual Report to Congress 7-8 (Most Serious Problem: *The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*) (noting that “[o]nline accounts work well for ‘cookie cutter’ transactions. ... When dealing with the IRS, little is ‘cookie cutter’ and much is case-specific.”).

12 Julia Klier, Regina Pfleger, & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, *Wirtschaftsinformatik Proceedings Paper* 13, 186-7 (2015).



which varied depending on the service they needed.<sup>13</sup> Moreover, a mix of channels for each service was usually needed to accommodate all preferences.<sup>14</sup>

Analysis of customer preference in the banking sector yields similar insights. Some transactions, such as opening or closing an account, applying for a loan, or seeking financial advice, lie at one end of the human-to-digital continuum.<sup>15</sup> For these complex or emotionally charged transactions, most customers prefer in-person interaction at a branch. At the other end of the continuum, most customers preferred to receive statements by mail or online.<sup>16</sup> Customers' satisfaction and engagement with the bank declined when they could not or did not use their preferred delivery channel, and the decline was greater when they did not use the channel they preferred for the highly emotional, complex transactions.<sup>17</sup>

Even investment banks offering “robo-advisor” services (in which computer programs provide investment advice online, typically for less than half the fees of traditional brokerages) report similar experiences.<sup>18</sup> Customers may not seek advice from an actual person when markets are rising, but as markets fluctuate, customers want the option to speak with someone. As one professional noted, “[t]here are times when people just want to talk — even if it's just to reinforce that they're doing the right thing. Without access to a professional when the market gets choppy, there's a risk that some investors might make emotional decisions that they'll regret later.”<sup>19</sup>

Applying these insights to tax administration, if a taxpayer prefers telephone or in-person communication and that channel is not available, the taxpayer may feel alienated, frustrated, and disengaged from the tax system. He may make an emotional decision that he will regret later, such as ignoring the IRS's messages or agreeing to the IRS's adjustments to his return even though he believes the IRS is wrong.

### *The Information and Surveys the IRS Has Relied on in Developing the “Future State” Have Important Limitations*

The IRS has used various methodologies to conduct surveys relating to taxpayer services:

- Contacting taxpayers on their landline telephones or cellphones;
- Delivering a paper survey to taxpayers in person and collecting the completed survey; and
- Using “online panels” — groups of participants who, in response to an invitation, take part in a survey by completing it online.<sup>20</sup>

13 Julia Klier, Regina Pflieger, & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, *Wirtschaftsinformatik Proceedings Paper 13*, 187 (2015).

14 *Id.*

15 Daniela Yu & John H. Fleming, *How Customers Interact With Their Banks*, *GALLUP BUSINESS JOURNAL* (May 2013), <http://www.gallup.com/businessjournal/162107/customers-interact-banks.aspx?version=print>.

16 *Id.*

17 *Id.*

18 Hugh Son & Margaret Collins, *The Rich Are Already Using Robo-Advisors, and That Scares Banks*, *BLOOMBERG BUSINESS* (Feb. 5, 2016).

19 Ben McLannahan, *‘Robo-advisers’ Try to Calm Investor Nerves*, *FINANCIAL TIMES* (Feb. 1, 2016) (quoting Tobin McDaniel, San Francisco-based president of Schwab Wealth Investment Advisory).

20 For a summary of various IRS surveys relating to taxpayer services, see Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

In developing online taxpayer accounts, the IRS has placed particular reliance on an online panel survey, the *W&I Web-First Conjoint Study* (Conjoint Study).<sup>21</sup>

As an online panel survey, the Conjoint Study may provide insights about the needs and preferences of taxpayers who are already online. However, a sizeable portion of U.S. households, 33 percent, do not have access to broadband internet at home.<sup>22</sup> Their needs and preferences are not reflected in the Conjoint Study, and they may not be able to rely on an online account. Moreover, according to Pew Research, a drawback of panel surveys is that panelists who are members of racial and ethnic minority groups may not be representative of these groups more broadly.<sup>23</sup>

Significantly, the survey instrument used in the Conjoint Study is not designed to elicit taxpayers' preferences, but requires respondents to select from among a limited number of specified alternatives. For example, one survey question is:

**Question:** People need help with many issues related to taxes. For each of the service needs listed, indicate if you have ever needed to complete the task:

1. Make a payment;
2. Obtain a copy of a tax transcript;
3. Obtain tax account information;
4. Have identity authenticated for tax-related purposes.<sup>24</sup>

The respondent cannot indicate that he or she needed another type of service or needed to complete a different task, such as responding to an IRS adjustment to a return or entering into an installment agreement.<sup>25</sup> The survey then explores taxpayers' preferred delivery channels, but only with respect to those four services.

In contrast, the ongoing TAS Service Priorities Survey, conducted by calls to land lines and cellphones, includes open-ended questions. For example, one question is:

**Question:** You mentioned that you have contacted the IRS in the past 12 months. Did you contact the IRS for any of the following reasons? Please say yes or no to each one.

The taxpayer can indicate whether he or she used any of ten specified services, such as "Get a form or publication," or "Get answers to your tax law question." The 11th option is "Or did you contact the IRS for some other reason — specify."

21 IRS, *Facilitating Access to Convenient & Efficient IRS Service: W&I Web-First Conjoint Study* (Sept. 30, 2016). A conjoint study, often used to evaluate tangible products, uses a tradeoff approach that provides a series of different scenarios and asks participants which option they prefer for each. Participants must choose from among the offered options. This approach assumes participants have complete knowledge, preferably based on experience, of the topic that is the subject of the survey — in this instance, all different IRS service tasks and delivery options.

22 John B. Horrigan & Maeve Duggan, Pew Research Center, *Home Broadband 2015*, 2 (Dec. 21, 2015).

23 Courtney Kennedy, Andrew Mercer, Scott Keeter, Nick Hatley, Kiley McGeeney, & Alejandra Gimenez, Pew Research Center, *Evaluating Online Nonprobability Surveys; Vendor Choice Matters; Widespread Errors Found for Estimates Based on Blacks and Hispanics* (May 2, 2016).

24 Question 6, IRS, *Web-First Conjoint Study Survey Instrument*.

25 For a discussion of the TAS Service Priorities Survey, see Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

In another survey, the IRS asked taxpayers seeking face-to-face assistance at Taxpayer Assistance Centers (TACs) to complete a paper questionnaire.<sup>26</sup> The questionnaires were distributed to taxpayers already at the doors of the TACs.<sup>27</sup> Taxpayers who were turned away after waiting outside the TAC in hopes of being seen by an assistor were never surveyed.<sup>28</sup> For many TACs during filing season, the number of taxpayers needing assistance and waiting outside the TAC was far greater than the number granted appointments and admitted to the TAC. Thus, the IRS has no information about the services and assistance needed by taxpayers who were unserved by the TAC or who did not make an appointment.

Similarly, in the Conjoint Study, the IRS asked respondents whether they had visited a local IRS office in the last two years. If so, the respondent was asked “For the most recent interaction, did you:”

- Walk in for face-to-face service with a representative;
- Make an appointment for face-to-face service with a representative; or
- Serve yourself with no live assistance provided by a representative.<sup>29</sup>

There is no menu option for the respondent to report that he or she visited a TAC but did not receive *any* assistance. Thus, the IRS does not know what these taxpayers’ needs were or if they were ever met.

### *The IRS’s Vision of How Taxpayers Will Perceive or Use Online Accounts May Not Reflect Taxpayers’ View of Reality*

The IRS uses detailed scenarios, or “vignettes,” as the most detailed illustrations of how it perceives the IRS “Future State” will operate. The vignettes, now posted to the IRS website, describe how various types of taxpayers might interact with the agency through online accounts, which became available on November 16, 2016.<sup>30</sup> One vignette describes Jane, an individual taxpayer who electronically files a return on which she claims the Earned Income Tax Credit (EITC).<sup>31</sup> When the IRS proposes to disallow the claimed EITC, Jane ultimately (and seamlessly) uses her online account to “resubmit” her return.<sup>32</sup>

26 IRS, *Taxpayer Assistance Center Customer Expectations Survey* (2013). The survey is carried out every three years; the survey for 2016 has been completed and the results are being compiled. At most TACs, taxpayers are required to make appointments for assistance, although managers have discretion to provide service to taxpayers without appointments. Internal Revenue Manual 21.3.4.2.4.2, *TAC Appointment Exception Procedures* (Oct. 21, 2016).

27 According to the IRS, “[t]he survey administrators position themselves at the door of the TAC and everyone who comes to the TAC is invited to take the survey.” IRS response to TAS fact check (Dec. 19, 2016).

28 There were long lines at some TACS and some TACs had to advise taxpayers as early as 9:30 in the morning that the office would not be able to serve additional taxpayers that day. See Treasury Inspector General for Tax Administration (TIGTA), Rep. No. 2016-IE-R010, *Selected Taxpayer Assistance Centers Were Professional and Organized, and Sensitive Information and Equipment Were Properly Secured* (Sept. 13, 2016), which includes photographs of long lines of taxpayers waiting outside TACs.

29 Question 5, IRS, *Web-First Conjoint Study Survey Instrument*.

30 *Future State and IRS Activities*, <https://www.irs.gov/uac/newsroom/future-state-and-irs-activities>. There are vignettes featuring an accountant employed by a state government (<https://www.irs.gov/pub/newsroom/irs-government-entity-vignette-version-a.pdf>); an individual taxpayer (<https://www.irs.gov/pub/newsroom/irs-individual-vignette-version-a.pdf>); a small business taxpayer (<https://www.irs.gov/pub/newsroom/irs-small-business-vignette-version-a.pdf>); and a large business taxpayer (<https://www.irs.gov/pub/newsroom/irs-large-business-vignette-version-a.pdf>). Features of the first release of the online account technology are described below.

31 *Individual Taxpayer Experience of the Future*, <https://www.irs.gov/pub/newsroom/irs-individual-vignette-version-a.pdf>. The EITC is an anti-poverty program consisting of a refundable tax credit available to certain low income working taxpayers and their families. See IRC § 32. For a full discussion of this vignette, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

32 This type of self-correction raises additional concerns. See National Taxpayer Advocate 2015 Annual Report to Congress 56, 62 (Most Serious Problem: *As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).

The online account in its present form does not give Jane this option. Currently, Jane could only view her balance due and make a payment.<sup>33</sup> When the first release of the technology is complete, Jane would still be able to do only four things via her online account:

- View her balance due;
- Make a payment;
- See payments that have been made; and
- Obtain a transcript of her account.<sup>34</sup>

There is no option for Jane to indicate she doesn't believe she owes the tax. There are no buttons she could click to learn, for example, how to file a protest, how to seek audit reconsideration or penalty abatement, how to file a refund claim, or how to file for "innocent spouse" relief. The National Taxpayer Advocate has urged the IRS to add these features to the online account pages.

The vignette also does not capture taxpayers' actual experience when the IRS audits their EITC return. According to a 2007 TAS survey of taxpayers whose EITC returns were audited:

- More than one-quarter of taxpayers receiving an EITC audit notice did not understand that the IRS was auditing their return;
- Almost 40 percent of the survey respondents did not understand what the IRS was questioning about their EITC claim;
- Only about half of the survey respondents felt that they knew what they needed to do in response to the audit letter;
- Even though slightly over half of the respondents indicated that they understood what was being questioned and knew what they needed to do, overall, more than 90 percent contacted the IRS;
- Seventy-two percent of the respondents said that they either called or visited the IRS in response to the letter;
- More than 75 percent of those taxpayers contacting the IRS about their audit letter did so by telephone; and
- Overall, 46 percent of respondents would have *preferred* to communicate about their audit with the IRS by telephone, and another 23 percent would have *preferred* to communicate in person.<sup>35</sup>

It is difficult to see how an online account, even one that allowed taxpayers to "interact" through drop down menus, could encompass the complexity of the American family unit.<sup>36</sup> As the "Future State" vignette illustrates, the IRS expects online accounts to be used by a large population (for Tax Year 2014, over 28 million taxpayers claimed the EITC) and with respect to issues for which online accounts may

33 The online account is accessed from the payments page on [irs.gov](https://www.irs.gov/payments/finding-out-how-much-you-owe). See *Finding How Much You Owe*, <https://www.irs.gov/payments/finding-out-how-much-you-owe>.

34 IRS, *View Your Tax Account Online* (Nov. 21, 2016), <http://win.web.irs.gov/articles/2016/View-your-tax-account-online.htm>.

35 See National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 93-116 (*IRS Earned Income Credit Audits — A Challenge to Taxpayers*) (describing surveys returned by 754 different taxpayers whose 2004 return claimed EITC and had been audited).

36 See Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra* (noting that the facts in an EITC case are often complex and fluid, since they involve the personal lives of taxpayers and thus are not suitable for resolution via a one-stop online experience); Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *infra*.

be singularly inappropriate.<sup>37</sup> The IRS has actual knowledge and data (from TAS studies) about what “audited” taxpayers prefer — and need — and yet its sole illustration shows it ignores that knowledge and imposes its own worldview.<sup>38</sup> Thus, the online account is not designed as a vehicle for engaging and educating taxpayers. On the contrary, it may communicate to taxpayers the IRS’s lack of interest in engaging with them.

### Best Practices Start With Looking at Taxpayers’, As Opposed to the Tax Administration’s, View of Reality

The OECD, having identified shortcomings in the way in which tax administrations measured and managed demand for taxpayer services, provided practical advice on how to address those shortcomings.<sup>39</sup> The first step is simply to know the tax administration’s “clients” — taxpayers.<sup>40</sup>

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The Swedish Tax Agency’s guiding principle is that “[w]hat we think is efficient, may turn out not to be, and what we think is good service is not necessarily so from the taxpayer’s perspective. We have understood the importance of not building our service based on our own internal view of reality.”

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The Swedish tax agency, lacking any agenda to “force taxpayers to certain channels,” exemplifies success in providing taxpayer service.<sup>41</sup> The agency surveys taxpayers about their experiences with various service channels, usually four times a year, and follows up with more qualitative surveys to understand the underlying reason for the quality of the experience. Its guiding principle is that “[w]hat we think is efficient, may turn out not to be, and what we think is good service is not necessarily so from the taxpayer’s perspective. We have understood the importance of not building our service based on our own internal view of reality.”<sup>42</sup> Put another way, “best-in-class tax administrations are taking a different approach to digitization. Going digital is no longer about making digital channel usage mandatory for 100 percent of citizens — it is about improving the taxpayer experience one segment or service at a time.”<sup>43</sup>

37 IRS, *EITC — A Big Tax Break for Working People Who Qualify*, [http://win.web.irs.gov/articles/2015/EITC\\_Spread\\_the\\_word.htm](http://win.web.irs.gov/articles/2015/EITC_Spread_the_word.htm) (Jan. 26, 2015).

38 For a description of the TAS Service Priorities Survey, which uses an online panel and telephone contact to explore taxpayers’ service delivery preferences, behavior patterns, and knowledge of Affordable Care Act requirements, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

39 OECD *Managing Service Demand: A Practical Guide to Help Revenue Bodies Better Meet Taxpayers’ Service Expectations*, 3 (2013). The guide, prepared by the Australian Taxation Office, was supported by a task group of 12 countries: Canada, Chile, Finland, Ireland, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey, and the United Kingdom.

40 *Id.* at 24. The report includes concrete, detailed suggestions of how this might be done, such as seeking direct feedback, using online communities, and mining external social media sites. *Id.* at 24-25, Table 4.1.

41 According to one study of Swedish government agencies, “the Tax Administration was in an absolute top position and won convincingly over the other agencies. In fact, the service score for the agency was so high that they ended up in the summary clearly ahead of most public companies regardless of line of business.” Vilhelm Andersson, *Mechanisms for Measuring the Quality of Service Provided to the Taxpayer and Results Achieved*, Inter-American Center of Tax Administrations – CIAT, 46th CIAT General Assembly, *Improving the Performance of the Tax Administration: Evasion Control and Taxpayer Assistance*, 171 (Apr. 2012).

42 *Id.* at 169.

43 Aurélie Barnay, Thomas Dohrmann, Wopke Hoekstra, Jose Nogueira, Fiyinfolu Oladiran, & Kristine Romano, *Tax Myths-Dispelling Myths About Tax Transformation in Rapidly Growing Economies* McKinsey & Company, 5 (Sept. 2015).

### Some Tax Administrations and Local Governments Reap Benefits From Providing In-Person Service That Digital Channels Do Not Provide

Tax administrations generally recognize the need to accommodate taxpayer preferences for in-person assistance where the taxpayer is remote. For example, New Zealand’s Inland Revenue sends an employee each year to the Chatham Islands (located more than 800 kilometers from New Zealand) to assist the 609 residents with tax matters.<sup>44</sup> Inland Revenue’s regular presence in this close and private community “has had a huge impact, not only for reducing debt but also in terms of their acceptance of Inland Revenue.”

Just as important is recognizing that the category of “remote” users of a government service may include not only those in rural areas but also those in an urban environment who are nevertheless isolated because of personal circumstances or due to other causes such as a natural disaster.<sup>45</sup>

## CONCLUSION

As other tax administrations and the private sectors in other parts of the world have found, taxpayers and other customers usually prefer a mix of service channels. Moreover, a user’s preferred service channel depends on the service being sought and whether it involves an emotionally charged transaction. Thus, research into taxpayers’ preferences — what they prefer and why — is essential before planning any initiatives that affect taxpayer service. World-class tax administrations consider taxpayer service from the taxpayers’ perspective and commit to honoring taxpayers’ preferences, not just because it is the right thing to do but because it makes good business sense and promotes compliance. The IRS, by relying on information and surveys that are not designed to elicit *taxpayers’* preferences, is falling short of that standard and may be impeding taxpayers from engaging with it.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct any taxpayer service surveys by calling taxpayers’ land line telephones or cellphones, or by sending taxpayers the survey by mail.
2. In surveys of TACs, include taxpayers who attempted to use TAC services but were turned away.
3. In taxpayer service surveys, include menu options (such as “other”) that allow respondents to indicate that the given alternatives do not describe their experience or preference.
4. In developing taxpayer service surveys, use focus groups and pre-testing with real taxpayers to ensure the surveys reflect all the potential preferences of taxpayers.
5. In implementing taxpayer service programs, place highest priority on meeting the preferences of taxpayers and stakeholders.
6. Implement procedures to safeguard against adopting service methods that have as their implicit or explicit objective forcing taxpayers to online channels.

44 *Mechanism Implemented for Assisting Taxpayers in Remote Geographical Areas*, Inter-American Center of Tax Administrations – CIAT, 46th CIAT General Assembly, Tax Administration New Zealand 186 (Apr. 2012).

45 For a discussion of the benefits of having a local presence, see Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*, *infra*.



MSP  
#3**IRS STRUCTURE: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Debra Holland, Commissioner, Wage and Investment Division  
 Sunita Lough, Commissioner, Tax Exempt and Government Entities Division  
 Douglas W. O'Donnell, Commissioner, Large Business and International Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to give organizational units end-to-end responsibility for providing service to specific taxpayer population segments.<sup>2</sup> After RRA 98, the IRS created national operating divisions (ODs) named after four segments: Small Business/Self-Employed (SB/SE), Wage and Investment (W&I), Tax Exempt and Government Entities (TE/GE), and Large Business and International (LB&I).

However, taxpayers generally do not receive end-to-end service from a single OD. SB/SE, LB&I, and TE/GE allocate only about one percent, zero percent, and four percent, respectively, to service, whereas W&I allocates 82 percent to it.<sup>3</sup> For example, SB/SE's only service function is Communications and Stakeholder Outreach, which primarily focuses on providing information to stakeholders rather than taxpayers.<sup>4</sup> By contrast, W&I's only "enforcement" function is Return Integrity and Compliance Services

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998); JCT, General Explanation of RRA 98, JCS-6-98, 17 (1998).

3 IRS Chief Financial Officer (CFO) response to TAS information request (Oct. 12, 2016).

4 SB/SE has the following top-level organizations: Collection, Exam, and Operations Support (OS). OS includes: Technology Solutions, Communications and Stakeholder Outreach (CSO), Human Capital, Finance, Research and Strategy, Servicewide Operations, and Leadership Development. SB/SE, *Operating Unit Org Charts* (Nov. 16, 2016). According to SB/SE, its service appropriation is allocated to Stakeholder Liaison Field (SLF) employees. SB/SE response to TAS fact check (Nov. 22, 2016). SLF is a component of CSO, which focuses "on the needs of the taxpayers with the expectation that all information provided [to stakeholders] reaches the taxpayer." *Id.*



(RICS), which focuses on preventing improper refunds.<sup>5</sup> As a result, no single unit is responsible for either SB/SE or W&I taxpayers. These taxpayers receive most services from W&I, but SB/SE audits and collects delinquencies from them. The IRS's functional structure presents the following challenges:

- No unit below the Deputy Commissioner for Services and Enforcement (DCSE) has the authority to ensure functions collaborate.<sup>6</sup>
- Each function focuses on completing tasks quickly without sufficient regard for the downstream consequences to other functions or taxpayers.<sup>7</sup>
- IRS “enforcement” functions waste resources and create problems when they use enforcement tools before working with service functions to address the root causes of compliance problems using the most effective and least burdensome alternative treatment(s) (e.g., educating taxpayers, alerting them to apparent discrepancies and improving guidance, and improving forms, communications, and outreach).<sup>8</sup>

If the IRS has not tried alternatives before resorting to enforcement, then the enforcement may be unnecessary. The use of unnecessary coercion violates the *rights to quality service, to a fair and just tax system, to privacy*, and in some cases *to pay no more than the correct amount of tax*. Moreover, when the IRS violates taxpayer rights, it likely reduces voluntary compliance by eroding trust for the IRS and promoting the view that noncompliance is justified.<sup>9</sup> In addition, the IRS's service functions may waste resources if they do not use information from enforcement functions to identify the services taxpayers need to help them comply.

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- 5 Internal Revenue Manual (IRM) 1.1.13.6 (Oct. 7, 2013); IRS, *Wage & Investment Division At-a-Glance* (May 6, 2016), <https://www.irs.gov/uac/wage-investment-division-at-a-glance>. According to W&I, its Identity Theft Victims Assistance organization is also funded from “enforcement” dollars. W&I response to TAS fact check (Nov. 21, 2016). When we use the term “enforcement” in quotes, we are referring to the IRS's overly-broad definition (e.g., any action by a so-called IRS “enforcement” function); when we use it without quotes, we are referring to its more natural meaning — the IRS's use of coercive power to compel action (e.g., assessment, summons, lien, levy, and the withholding of refunds). See THE OXFORD ENGLISH DICTIONARY, [http://www.oxforddictionaries.com/us/definition/american\\_english/enforcement](http://www.oxforddictionaries.com/us/definition/american_english/enforcement) (“The act of compelling ...”). For further discussion of this issue, see Nina E. Olson, *The Future of Tax Administration*, 2016 TNT 49-11 (Mar. 10, 2016) and Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.
- 6 See, e.g., IRS, *IRS to Realign Compliance Operations* (Nov. 3, 2014), <https://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (“The goal of the realignment is to primarily focus SB/SE on post-filing compliance and W&I on pre-refund compliance.”).
- 7 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*).
- 8 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*); National Taxpayer Advocate 2014 Annual Report to Congress 31-39 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).
- 9 See, e.g., Tom Tyler, *Legitimacy and Criminal Justice: The Benefits of Self-Regulation*, 7 OHIO ST. J. CRIM. L. 307-359 (2009); Erich Kirchler, *The Economic Psychology of Tax Behaviour* 203-205 (2007); Most Serious Problem: *The IRS Can Increase Voluntary Compliance Using Behavioral Science Insights, But Is Overly Focused on So-Called “Enforcement” Revenue and Productivity*, *supra*.

## ANALYSIS OF PROBLEM

### Before 1998, Local Managers Who Engaged the Community Had the Authority to Require Local Service and “Enforcement” Functions to Work Together

Before 1998, the IRS served every taxpayer at one of ten centralized IRS service centers and 33 local district offices.<sup>10</sup> Each district director assigned taxpayer education programs to the examination or collection functions within their districts.<sup>11</sup> This structure reportedly developed creative and technically-savvy managers accustomed to addressing local compliance problems using more than one function and communicating with and being accountable to the public.<sup>12</sup>

However, because district employees had to serve every type of taxpayer, they could not focus on a segment’s needs or maintain the technical expertise to address all of the issues that might arise.<sup>13</sup> Serving each taxpayer from both a district office and a service center also raised concerns about consistency and accountability.<sup>14</sup> In addition, competition on enforcement productivity measures (*i.e.*, records of tax enforcement results, or ROTERS) led to abuses that eroded public confidence.<sup>15</sup> Moreover, IRS “enforcement” functions focused on short-term processing efficiencies (*e.g.*, closures) rather than identifying the root causes of noncompliance.<sup>16</sup>

### The IRS Restructuring and Reform Act of 1998 (RRA 98) Required the IRS to Give Units End-To-End Responsibility for Serving Specific Taxpayer Segments, But the IRS Has Interpreted It Narrowly

RRA 98 contemplated that the IRS would improve service and accountability by assigning one employee to handle a taxpayer’s matter until it was closed,<sup>17</sup> including the employee’s name and telephone number

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- 10 S. Rep. No. 105-174, at 9 (1998); Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 16-17 (1998); IRS Pub. 3349, *Modernizing America’s Tax Agency* 1-10 (Apr. 2000), <https://www.irs.gov/pub/irs-utl/27877d00.pdf>.
  - 11 IRM 22.30.1.1.2 (Jan. 1, 2002).
  - 12 See Frank Wolpe, *A White Paper on Executive Action to Restore Trust in the Internal Revenue Service by Rebuilding Field Operations*, American Bar Association (ABA), Section of Taxation, News Quarterly 17 (2014), [http://www.tnorrslaw.com/pdf/FW\\_WhitePaper.pdf](http://www.tnorrslaw.com/pdf/FW_WhitePaper.pdf). Similarly, traditional police enforcement strategies are not as effective in reducing crime as working with community partners to address the underlying problems (called problem-oriented policing, or POP) at the local level. See, e.g., David Weisburd et al., *Is Problem-Oriented Policing Effective in Reducing Crime and Disorder? Findings From a Campbell Systematic Review*, 9 CRIMINOLOGY & PUB. POL. 139, 141, 162 (2010), [http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd\\_et\\_al.pdf](http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd_et_al.pdf).
  - 13 See, e.g., *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. 12, 14 (1998) (testimony of Charles Rossotti, Commissioner of Internal Revenue), <https://www.irs.gov/pub/irs-news/ir-98-3.pdf> (“The IRS organizational structure no longer enables its managers to be knowledgeable....Since each [new] unit will be fully responsible for serving a set of taxpayers with like needs, the management teams responsible for each of these units will be able to become knowledgeable about the needs and problems of their customers, and be held fully accountable for achieving specific goals in serving them.”).
  - 14 See, e.g., *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. 12 (1998) (testimony of Charles Rossotti, Commissioner of Internal Revenue). Although consistency issues can be minimized through transparent procedures, some problems may be inevitable, as even campuses can have inconsistent procedures. See, e.g., National Taxpayer Advocate 2004 Annual Report to Congress 132-42 (Most Serious Problem: *Inconsistent Campus Procedures*).
  - 15 See Douglas M. Browning et al., *Special Review Panel Report for Charles O. Rossotti, Commissioner, IRS* (Aug. 1998). Similarly, among local police organizations an excessive focus on efficiency statistics including reported crime statistics and revenue from tickets, rather than on the means used, can lead to misreporting of crime, abuse of power, and a dysfunctional organizational culture. See, e.g., Malcolm Sparrow, *HANDCUFFED, WHAT HOLDS POLICING BACK, AND THE KEYS TO REFORM* 20-22 (2016).
  - 16 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 20 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>. (“Employees believe that [performance metrics] do not measure long-term quality performance accurately. Consequently, employees put an emphasis on short-term performance and meeting goals of efficiency ... One of the most significant efforts that the IRS must undertake is to redesign its internal measurement system to encourage behavior which makes it easy for taxpayers to interact with the IRS.”).
  - 17 RRA 98, Pub. L. No. 105-206, § 3705(b), 112 Stat. 685, 777 (1998).

on any “manually generated correspondence,”<sup>18</sup> providing callers with the option to talk to an employee who could help,<sup>19</sup> and placing the addresses and telephone numbers for local offices in phone directories across the country.<sup>20</sup> RRA 98 also directed the IRS to: (1) establish “organizational units serving particular groups of taxpayers with similar needs;”<sup>21</sup> (2) “restate its mission to place a greater emphasis on serving the public and meeting taxpayers’ needs;”<sup>22</sup> and (3) adopt “balanced measures,” including customer and employee satisfaction, to counter “efficiency and productivity” metrics.<sup>23</sup> Legislators believed that increasing the IRS’s focus on customer service would improve voluntary compliance by promoting public confidence in the IRS.<sup>24</sup>

The IRS could have responded to RRA 98 by assigning units and individual IRS employees with more responsibility for providing end-to-end service to specific taxpayers or taxpayer segments, potentially increasing their communications with and accountability to taxpayers. However, the IRS has interpreted these directives narrowly.<sup>25</sup> Its interpretation has enabled it to shift more work from highly-trained field employees to lower-graded campus employees who have less authority and are assigned narrower issues and mechanical tasks.<sup>26</sup>

18 RRA 98, Pub. L. No. 105-206, § 3705(a), 112 Stat. 685, 777 (1998).

19 RRA 98, Pub. L. No. 105-206, § 3705(d), 112 Stat. 685, 777 (1998).

20 RRA 98, Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998). At recent public forums, stakeholders reiterated their preference for personal service. See, e.g., Oral Statement of Jennifer MacMillan, Chair, Internal Revenue Service Advisory Committee (IRSAC), National Taxpayer Advocate Public Forum 93 (Feb. 23, 2016), <http://taxpayeradvocate.irs.gov/public-forums> (“[T]he number one issue that I think builds trust among taxpayers and practitioners with the IRS is to have a person that they can deal with either by phone or face-to-face. I think that is the most crucial thing required. And I don’t see that going away even with advances in the digital tools.”); Oral Statement of Robert Wall, Esq. Attorney, Member, Spilman Thomas & Battle, PLC, National Taxpayer Advocate Public Forum 59 (Apr. 4, 2016) (“The golden ticket, when dealing with the IRS, as everyone will back me up, is when you get a letter with someone’s name and phone number on it. And when that happens, I would say nine times out of ten you can get an answer within 15 minutes.”).

21 RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998). For further discussion of the restructuring, see, e.g., IRS Pub. 3349, *Modernizing America’s Tax Agency* (Apr. 2000).

22 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998). See also National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 20 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf> (“Reorganizing into specialized units focused on taxpayer needs, rather than IRS internal needs, should better serve the American public.”).

23 See RRA 98, Pub. L. No. 105-206, Title I, §§ 1204, 112 Stat. 722, 9508(a)(2) (1998); J. Comm. on Tax’n, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998* 47-50 (1998); T.D. 8830, 64 Fed. Reg. ¶ 42,834 (Aug. 6, 1999) (explaining “[t]he presence of measures that evaluate the quality of the work done by the unit, the satisfaction of customers served by the unit (including taxpayers), and the satisfaction of employees working in the unit will obviate the risk that managers place undue emphasis upon the quantity of work completed.”).

24 See, e.g., JCT, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (1998) (“the Congress believed that most Americans are willing to pay their fair share of taxes, and that public confidence in the IRS is key to maintaining that willingness.”).

25 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 134-44 (Most Serious Problem: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*); National Taxpayer Advocate 2014 Annual Report to Congress 145-53 (Most Serious Problem: *The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*); National Taxpayer Advocate 2014 Annual Report to Congress 123-33 (Most Serious Problem: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*).

26 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45.

## IRS Employees Need Sufficient Authority, Technical Expertise, and Communication With Taxpayers to Improve Service and Compliance

Stakeholders have recently complained that IRS employees sometimes do not have sufficient expertise,<sup>27</sup> or authority to resolve problems.<sup>28</sup> Stakeholders have also observed that employees need to communicate with taxpayers enough to understand the reason(s) for apparent discrepancies, and resolve cases correctly.<sup>29</sup>

Similarly, employees will not be able to identify appropriate alternative treatment(s) to address the root causes of noncompliance if they do not have enough personal communications with taxpayers. RRA 98 contemplated that these communications would occur. It provided that “front-line technical experts” with an understanding of taxpayer problems would report back to the tax writing committees with respect to the “administrability” of pending amendments to the tax code,<sup>30</sup> and that the IRS would report to Congress each year on the sources of complexity in tax administration and on ways to reduce it.<sup>31</sup>

It may be easier for the IRS to manage campus employees charged with narrow tasks. However, their geographic isolation, narrow knowledge base, and limited authority likely make it more difficult for them to understand and communicate with taxpayers and resolve their problems.<sup>32</sup> An organizational design textbook elaborates on some these concerns as follows:

[A] service firm[’s] ... greatest economies are achieved through disaggregation into small units that can be located close to customers. Stockbrokers, doctors’ clinics, consulting firms, and banks disperse their facilities into regional and local offices ... These employees need enough knowledge and awareness to handle customer problems rather than just enough to perform mechanical tasks. Employees need social and interpersonal skills as well as technical skills. Because of higher skills and structural dispersion, decision making often tends to be

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- 27 See, e.g., Oral Statement of Rollin Groseclose, CPA, Johnson, Price, Sprinkle, PA, National Taxpayer Advocate Public Forum 64-65 (Apr. 4, 2016) (“... we use practitioner priority ...and they can’t always find the answer, or they will give a recommendation and it doesn’t quite line up with the documentation we received. So they seem to have limited, either training in some instances, or access to information within the databases that the IRS has.”); Oral Statement of Audience Member, National Taxpayer Advocate Public Forum 47-48 (May 5, 2016) (“...you’re still dealing with fairly uneducated people on those lines. If it’s not on their checklist, and I can literally hear them going down the — okay, what are you talking about, okay, let me get my — I hear pages flipping or something or the computer system is slowing down. I cannot imagine how another taxpayer without some basis of knowledge would be able to get satisfaction or resolution to the question.”).
- 28 See, e.g., Coalition for Effective and Efficient Tax Administration, *CEETA Addresses Changes Under Way in LB&I Division*, 2016 TNT 140-13 (July 21, 2016) (“taxpayers typically want a single point of contact ... Under the new structure, the first point of convergence of the nine practice areas, i.e., so-called tie-breaking authority, is the Deputy Commissioner .... Taking issues all the way to the Deputy Commissioner level for resolution will be a long, frustrating process for both taxpayers and IRS personnel and will add to the potential for conflict in the examination process.”); Oral Statement of Elizabeth Atkinson, Esq., LeClairRyan, PC, National Taxpayer Advocate Public Forum 82-83 (May 13, 2016) (“... when I worked at the IRS, there were a lot of really good IRS employees who want to do the right thing for the taxpayer. Often, they are unable to do that because there is a gap in authority.”).
- 29 See, e.g., Oral Statement of Warren Hudak, EA, President, Hudak & Company, National Taxpayer Advocate Public Forum 24-25 (Apr. 8, 2016) (“Oftentimes, during the course of an audit, the taxpayer is — has taken a position on an issue that is perfectly fine, but because they don’t understand the language of the law, they don’t understand the language of regulations, they inaccurately communicate their point, their perspective, their position. And it isn’t because they’re taking an improper position, but because they don’t know how to communicate it properly.”).
- 30 RRA 98, Pub. L. No. 105-206, Title IV, § 4021, 112 Stat. 685, 785 (1998). The IRS does not facilitate such communications. See National Taxpayer Advocate 2014 Annual Report to Congress 108-11 (Most Serious Problem: *The IRS Has No Process to Ensure Front-line Technical Experts Discuss Legislation with the Tax-writing Committees as Requested by Congress*).
- 31 RRA 98, Pub. L. No. 105-206, Title IV, § 4022(a), 112 Stat. 785 (1998). The IRS no longer produces a complexity report. See National Taxpayer Advocate 2014 Annual Report to Congress 102-07 (Most Serious Problem: *The IRS Does Not Report on Tax Complexity As Required by Law*).
- 32 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45 (Most Serious Problem: *The Lack of A Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

decentralized in service firms, and formalization tends to be low. Although some service organizations, such as many fast-food chains, have set rules and procedures for customer service, employees in service organizations typically have more freedom and discretion on the job ... The concept of separating complex tasks into a series of small jobs and exploiting economies of scale is a cornerstone of traditional manufacturing, but researchers have found that applying it to service organizations often does not work so well ...<sup>33</sup>

Moreover, between 1970 and 2014, financial institutions, whose business models the IRS initially emulated, were opening local branches at a rate nearly twice as fast as U.S. population growth.<sup>34</sup> Immediately after RRA 98, the IRS planned to address many of these issues by forming units responsible for narrower taxpayer segments, as shown for W&I in Figure 1.3.1.

33 Richard Daft, *ORGANIZATION THEORY AND DESIGN* 270-71 (10th ed., 2010).

34 See Federal Deposit Insurance Corporation (FDIC), Press Release, *Branch Banking Remains Prevalent Despite the Growth of Online and Mobile Banking* (Feb. 19, 2015), <https://www.fdic.gov/news/news/press/2015/pr15018.html>. Similarly, problem- and community-oriented policing is deemed so effective that the Department of Justice (DOJ) Office of Community Oriented Policing Services (COPS) provides grants to facilitate its adoption. DOJ, Congressional Justification, *FY 2017 Performance Budget* (Feb. 9, 2016), <https://www.justice.gov/jmd/file/821491/download>.



FIGURE 1.3.1<sup>35</sup>

| W&I TAXPAYER CHARACTERISTICS<br>Examples of Special Needs of Individual Taxpayer Market Segments |   |   |   |
|--|---|---|---|
| SEGMENT  | PROFILE   | KEY NEEDS   | PROPOSED STRATEGY TO ADDRESS NEEDS  |
| Segment I  | • Simple returns; low income (<\$30K); low tax understanding; language assistance; urban; possible dependents; possible compliance issues   | • Face-to-face contact required; tax education; needs hand-holding; language assistance   | • Focus on education about taxes; reach through walk-in centers; bi-lingual assistance  |
| Segment II   | • Simple returns; low to middle income; educated and computer proficient; understands taxes; prepare own returns; compliant   | • Need for accurate and fast access to IRS (through Internet); answers to specific questions  | • Aggressive marketing of e-commerce products; education on forms to file and taxation issues pertaining to them; greater access to electronic sites (e.g., through schools and universities)   |
| Segment III  | • Middle income families; average return complexity; familiar with taxation; typically paper filers; prepare own returns; compliant   | • Reliable information on tax law changes, new forms and procedures; prompt and accurate response to queries  | • Provide information on tax laws through direct mail; marketing of e-commerce products—migrating them toward e-commerce; provide more accessibility through new channels   |
| Segment IV   | • Complex returns, investment and schedules; high income; professionals and wealthy retirees; paid preparers; compliant   | • Customized assistance through preparers; need help with complex problems; easy access to tax information through preparers  | • No direct assistance required from IRS; focus on providing high-quality assistance to practitioners; leverage partnerships with practitioners to provide better service   |
| Segment V  | • Divorced/separated individuals; simple/average complexity of returns; low/middle income; low understanding of taxation; possible compliance problems  | • Increased understanding of tax system; recognition of their circumstances—possible hardship assistance; accessibility to someone who will solve their problems; clear explanation of child support test | • Basic tax education (e.g., seminars on return preparation); hardship programs; outreach through divorce courts, single parent associations  |
| Segment VI   | • Balance due and non-filers; some understanding of taxes; possible fear of the tax system; low understanding of collection options; financial problems; withholding (W-4) problems; frequently ignoring notices, contact attempts; prepare own returns | • Understanding of the collection process, options and implications; understanding of withholding; accessibility to tax help; reduction of penalties for honest mistakes                                  | • Aggressive marketing/clinics on collection options (installment agreements, offers in compromise and credit card settlement); information on reasonable cause incentives; providing specific help on the phone; quicker response to non-filing situations |
| Segment VII  | • Elderly/retired; low to middle income; Social Security/pension-based incomes; simple/middle complexity returns; prepare own returns; not computer literate; value face-to-face contact; easy to reach through retirement communities                  | • Face-to-face assistance/education; information on Social Security/pension changes; desire to volunteer; increased awareness of investment tax law changes; assistance on return preparation             | • Increased coordination with AARP and other relevant stakeholders; seminars and assistance on filing through community organizations; reach through VITA and TCE; joint ventures with Social Security, investment firms, banks, etc.                       |

35 This table appears as Exhibit A in IRS Pub. 3349, *Modernizing America's Tax Agency* 22 (1999).

IRS units responsible for smaller segments could better understand these segments, and use this specialized knowledge to improve service and compliance.<sup>36</sup>

### No IRS Unit Has End-To-End Responsibility or Accountability

The IRS continues to move away from the end-to-end service concept. In 2014, SB/SE and W&I realigned operations.<sup>37</sup> The goal was to improve processing efficiencies and to ensure a single executive has “end-to-end accountability for Collection and a single executive has end-to-end accountability for Examination.”<sup>38</sup> However, as noted above, exploiting economies of scale is more suited to manufacturing than service industries. The IRS solicited comments about the realignment from employees,<sup>39</sup> but not from its customers or external stakeholders.

No unit was assigned end-to-end accountability for specific segments.<sup>40</sup> Because SB/SE took responsibility for most post-refund compliance work for individuals,<sup>41</sup> even the W&I Commissioner does not have end-to-end responsibility for compliance by most individual taxpayers. Similarly, SB/SE, LB&I, and TE/GE devote a small fraction of their resources to assist the taxpayers they are named after.<sup>42</sup> As shown in Figure 1.3.2, for fiscal year (FY) 2016 only about one percent, zero percent, and four percent of their respective budgets were devoted to service.<sup>43</sup> By contrast, 82 percent of W&I’s FY 2016 budget was devoted to service.<sup>44</sup>

36 See, e.g., IRS Pub. 3349, *Modernizing America’s Tax Agency* 34 (1999) (“since the taxpayers served [by each unit] are reasonably homogeneous in their needs, it will be possible and expected for the managers at all levels to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their division.”); GAO, GAO/T-GGD-91-54 *Identifying Options for Organizational and Business Changes at IRS* (July 9, 1991), <http://www.gao.gov/assets/110/103988.pdf> (recommending the IRS consider: “assigning a single staff to perform both auditing of tax returns and collecting taxes due. Reinforcing accountability ... [and reorganize them] to focus on types of taxpayers with common noncompliance problems, thereby enhancing the expertise of the agency in dealing with industries with special or complex tax situations.”). The IRS briefly established units of examination and collection employees who would report to multi-functional managers. See IRS Pub. 3349, *Modernizing America’s Tax Agency* 1-15 (Apr. 2000).

37 Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014). The IRS did not document a business case for these changes. See, e.g., Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-IE-R005, *Several Changes Sought by the Internal Revenue Service Restructuring and Reform Act of 1998 Remain a Challenge* 6 (Mar. 28, 2016), <https://www.treasury.gov/tigta/iereports/2016reports/2016ier005fr.pdf>.

38 Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014); SB/SE, *General questions about the realignment* (Nov. 13, 2014). Even though the Examination and Collection functions are both lodged within SB/SE, they generally do not work together. See, e.g., TIGTA, Ref. No. 2016-30-070, *Examination Collectibility Procedures Need to Be Clarified and Applied Consistently* (Sept. 7, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630070fr.pdf>.

39 The IRS held 31 employee focus groups and town hall sessions at all ten campuses and considered more than 1,600 emails from employees before finalizing its realignment plans for SB/SE and W&I. Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014). The current IRS Commissioner is careful to consult employees before making organizational changes. See, e.g., *Prepared Remarks of Commissioner of Internal Revenue Service John Koskinen before the National Press Club*, IR-2014-42 (Apr. 2, 2014).

40 Taxpayers who claimed the Earned Income Tax Credit (EITC) or who had been the victim of identity theft would generally be assigned to specific units, however. Email from W&I and SB/SE Commissioners to all W&I Employees, *Organizational Realignment Announcement* (Oct. 8, 2014) (referencing the EITC).

41 IRS, *IRS to Realign Compliance Operations* (Nov. 3, 2014), <https://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (“this plan would move pre-filing compliance work to W&I and post-filing compliance work for individuals and small businesses to SB/SE”).

42 *Id.*

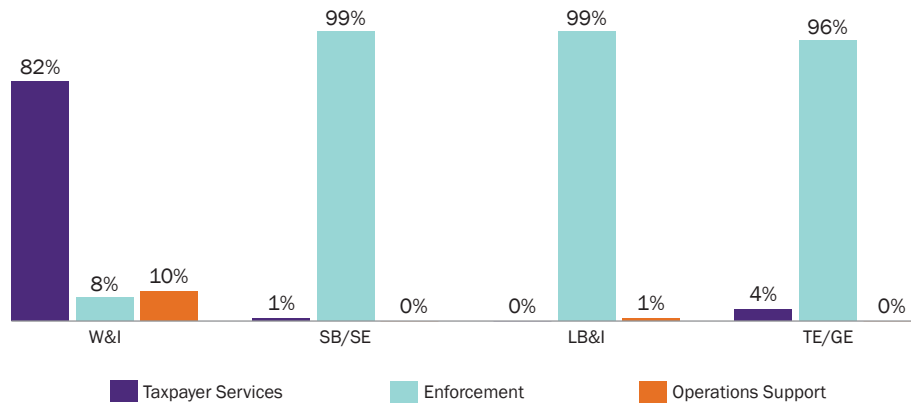
43 CFO response to TAS information request (Oct. 12, 2016).

44 *Id.*



FIGURE 1.3.2<sup>45</sup>

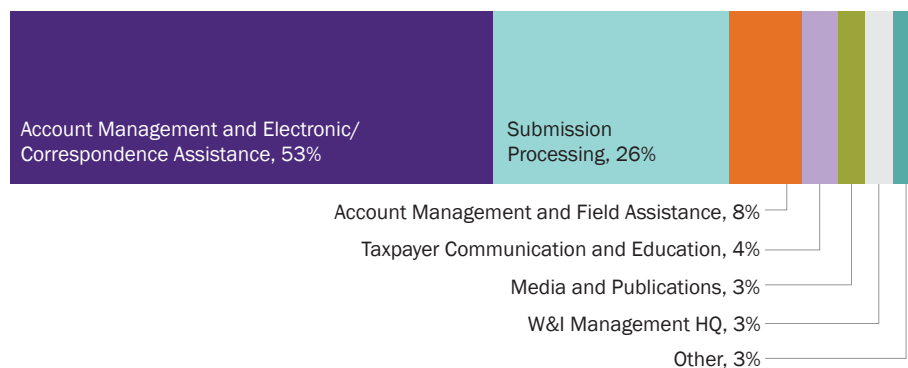
## Budget Allocation by Operating Division for FY 2016



The vast majority of W&I's service budget is allocated to agency-wide services such as processing correspondence and returns, answering calls, staffing assistance centers, and maintaining IRS-wide Internal Revenue Manuals (IRMs) and publications, as shown in Figure 1.3.3.

FIGURE 1.3.3<sup>46</sup>

## W&amp;I's Service Budget for FY 2016



Even before the recent realignment, most of W&I's budget was devoted to agency-wide services.<sup>47</sup> Thus, the IRS is even more organized around internal functions than it was before RRA 98. The National

<sup>45</sup> CFO response to TAS information request (Oct. 12, 2016). These figures do not include user fees.

<sup>46</sup> TAS analysis of W&I budget data (Oct. 13, 2016). These figures do not include user fees.

<sup>47</sup> National Taxpayer Advocate 2010 Annual Report to Congress 49-70 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding Its Ability to Serve Its Core Base of Individual Taxpayers Effectively*).

Taxpayer Advocate has recommended placing W&I's agency-wide back-office support functions into a separate organization so that W&I could focus on wage earners and investors.<sup>48</sup>

### In a Functional Organization, Each Function Needs to Be Accountable for Coordinating with Others

#### *The IRS's Functions Sometimes Focus on Narrow Productivity Measures Rather Than Broader Agency Goals*

To prevent errors, IRS "enforcement" functions need to identify the causes of noncompliance and communicate them to taxpayers, service functions, and other stakeholders so that the agency and its stakeholders can address them.<sup>49</sup> Instead, IRS "enforcement" functions generally focus on processing efficiency, perhaps because efficiency statistics are more readily available than information about root causes.<sup>50</sup> IRS examiners are no longer required to identify and record the reasons for misreporting, and the IRS no longer tracks the laws that trip up its own employees or reports on the sources of complexity.<sup>51</sup> LB&I has problems accurately tracking its audit adjustments by issue so that it knows where taxpayers are making the most significant errors.<sup>52</sup> Similarly, collection employees do not accurately record what actions prompt taxpayers to make payments.<sup>53</sup>

As another example, without doing any research that could help avoid burdening taxpayers unnecessarily, IRS "enforcement" functions allow computers to make inaccurate assessments or unnecessarily delay

48 See National Taxpayer Advocate 2010 Annual Report to Congress 49, 70 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding Its Ability to Serve Its Core Base of Individual Taxpayers Effectively*).

49 See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 20 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>. ("In a stovepipe operation, functional units such as taxpayer services, exam, collection, appeals, and counsel set and implement their own priorities and objectives, which often are disconnected from the other functions and the organization as a whole. This is why a taxpayer may receive a notice from the IRS, but when the taxpayer calls the toll-free number, the customer service representative is unable to help. ... The new IRS leadership team should establish performance measures that encourage functions within the IRS to cooperate. Additionally, the IRS should continue on the course begun in Compliance 2000, in which cross functional teams work together to solve problems. Finally, the Commission considered more far reaching reforms to break down functional stovepipes, including reorganizing the entire organization into four divisions ...").

50 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*). For example, LB&I's "Key Stats" report contains 14 substantive worksheets. LB&I response to TAS information request (June 23, 2016). The first 12 contain detailed enforcement productivity statistics (e.g., closures, dollars per hour, yield, hours per return, cycle time, no change rates, etc.) broken out by type of taxpayer, income level and issue (i.e., activity code). *Id.* Only the last two worksheets are devoted to quality, and customer and employee satisfaction data are not broken out by activity code, and for the last few years have not been broken out by industry. *Id.* LB&I's lack of disaggregated satisfaction data is due to IRS-wide changes to its survey process.

51 See National Taxpayer Advocate 2013 Annual Report to Congress 102 n.5 (Most Serious Problem: *The IRS Does Not Report on Tax Complexity As Required by Law*) (describing how the IRS is required to identify the areas of the tax code where taxpayers and revenue agents make frequent errors, but the IRS no longer tracks tax law errors by code section); National Taxpayer Advocate 2007 Annual Report to Congress 35, 57 (Most Serious Problem: *The Cash Economy*) (recommending that when the IRS's national research program examinations identify an error on a return, the IRS should determine the reasons why the taxpayer made the error).

52 See TIGTA, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 14, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630089fr.pdf>.

53 National Taxpayer Advocate 2014 Annual Report to Congress 221-26 (Most Serious Problem: *The IRS's Failure to Accurately Input Designated Payment Codes for All Payments Compromises Its Ability to Evaluate Which Actions Are Most Effective in Generating Payments*).

refunds.<sup>54</sup> These and similarly automated enforcement tools prompt communications to which the IRS cannot timely respond.<sup>55</sup> Automated IRS “enforcement” functions create these types of problems far too often.<sup>56</sup>

### *Procedural Requirements, Multi-Functional Compliance Projects, Teams, and Campaigns Could Help Ensure Functions Work Together*

Procedural safeguards could help mitigate problems caused by the IRS’s functional structure. For example, the IRS could require all “enforcement” functions to document the reasons for any noncompliance, communicate them to service functions, and implement alternative treatments before resorting to coercive ones.

The IRS could also establish more effective local and national multi-functional groups (*e.g.*, councils, program management offices, and cross-functional groups and initiatives). To be effective, these groups should have the responsibility and authority to identify compliance problems and implement alternative treatments to address them. The IRS has long known that multi-functional Compliance Initiative Projects (CIPs) could prevent noncompliance by identifying and delivering what a segment needs to comply.<sup>57</sup> In theory, an examination function could use CIP procedures to collaborate with other

<sup>54</sup> See, *e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 114, 119-20 (Research Study: *Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*); National Taxpayer Advocate FY 2017 Objectives Report to Congress 80, 82 (Area of Focus: *IRS Implementation and Enforcement of Withholding on Certain Payments to Foreign Persons Is Burdensome, Error-Ridden, and Fails to Protect the Rights of Affected Taxpayers*) (discussing how the IRS improperly denied or delayed tens of thousands of refunds to international students because of transcription errors and poor IRS data quality, rather than first investigating the reason(s) for apparent mismatches).

<sup>55</sup> See, *e.g.*, Oral Statement of Troy K. Lewis, Chair, Tax Executive Committee, AICPA, National Taxpayer Advocate Public Forum 72–73 (May 17, 2016) (“The income, which was reported to the IRS on a Form 1099-B, was properly reported on my client’s tax return, and the appropriate amount of income tax had actually been paid. There was no error on the return. However, due to requirements in its matching system, the IRS needed additional information to verify the income was indeed properly reported. The notice was a mere case of matching the third party information reported to the IRS with information reported on the return. However, it took me two letters and four months to resolve this notice. It was a highly inefficient experience and an example of where change is clearly needed.”).

<sup>56</sup> See, *e.g.*, National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*); National Taxpayer Advocate 2015 Annual Report to Congress 112-22 (Most Serious Problem: *The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer’s Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection*). TIGTA, *Actions Can Be Taken to Better Address Potential Noncompliance for Roth Individual Retirement Arrangement Conversions*, Ref. No. 2016-10-054 (Aug. 30, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201610054fr.pdf> (“Our review found that 97 (25 percent) of the 383 sampled cases had information that could have been researched on IRS systems that would have enabled AUR Program personnel to correctly conclude that minimal or no taxes were due on discrepancies resulting from Traditional IRAs being converted to Roth IRAs. In each of the 97 discrepancies, taxpayers received CP 2000 Notices. However, after correspondence with the taxpayer, little or no additional tax was assessed.”). As another example, the LB&I Commissioner had to ask W&I to stop its automated assessment of penalties for failure to file Forms 3520 and 3520-A due to concerns that these assessments were inaccurate. Memorandum from LB&I Commissioner to W&I Commissioner, *Direction to Close All Current Inventory Related to Forms 3520 & 3520A* (Mar. 20, 2013).

<sup>57</sup> Multi-functional CIPs are similar to the Compliance 2000 projects endorsed by the IRS and its stakeholders in the late 1990s. See, *e.g.*, National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 23, 27 (June 25, 1997).

functions to implement alternative treatments,<sup>58</sup> but “enforcement” functions use them primarily to identify returns to examine.<sup>59</sup>

The IRS provided TAS a list of 114 teams and highlighted several that it believes address compliance problems using a multi-functional approach.<sup>60</sup> For example, multi-functional issue management teams (IMTs) seem promising because they can address compliance problems using CIPs, proposed legislation, settlement offers, or guidance to the field, provided they coordinate with the Servicewide Compliance Strategy (SCS) Executive Steering Committee (ESC).<sup>61</sup> However, IMTs focus on abusive transactions rather than common transactions or local compliance issues.<sup>62</sup> In most cases, the development of a service-wide strategy must also be approved by high level executives on the SCS ESC. Moreover, W&I is not on the SCS ESC, potentially making it less likely to consider alternative treatments.

### *The Right Operational Measures Could Help Ensure Functions Work Together*

Functional managers are naturally interested in whether their employees are following procedures and working efficiently.<sup>63</sup> It may be more natural for them to focus on productivity than on the effect of their employees on taxpayers’ views of the agency and voluntary compliance. For example, collection employees may seem to have little ability to influence voluntary compliance or a taxpayer’s view of the agency. To counter this without making radical changes, the IRS could measure factors that likely affect voluntary compliance (*e.g.*, multi-functional collaboration on alternative treatments) and public perception of the agency (*e.g.*, respect for taxpayer rights), as recommended by the National Taxpayer Advocate.<sup>64</sup> IRS employees should be able to affect taxpayer behavior and attitudes by measurable amounts if the taxpayer segment is small enough.

58 IRM 4.17.1.4 (Feb. 25, 2010); IRM 4.17.4.4.1 (Feb. 25, 2010); Form 13498, *Compliance Initiative Project Authorization - Part Two* (Apr. 2009).

59 There may have been a few multifunctional CIPs, but they are not the norm. IRS response to TAS information request (June 22, 2016) (“SBSE Exam is not aware of any non-enforcement function working Compliance Initiative Projects.”); SB/SE response to TAS information request (Oct. 22, 2016) (“SBSE is still not aware of any non-enforcement functions working Compliance Initiative Projects.”); SB/SE response to TAS fact check (Nov. 21, 2016) (“During a cursory review of CIPs for this fact check request response, SB found two examples of multi-Functional CIPs .... We also have [six] examples where our Communication and Stakeholder Outreach function (CSO) [formerly known as Communication, Liaison, and disclosure (CLD)] has worked with our Examination function on a CIP and signed off on the CIP”). Alternative treatments could be used in most CIPs. For example, the IRS could send soft notices and educational materials to all of the taxpayers with apparent discrepancies to give them an opportunity to self-correct so that an examination would not be necessary.

60 IRS response to TAS information request (July 13, 2016).

61 See IRM 4.32.1 (June 5, 2014). The SCS ECC reports to the Enforcement Committee, which is chaired by the DCSE. *Id.* LB&I’s new “campaigns” could also use alternative treatments to address compliance problems. However, without direct access to any significant resources for service, it is not clear how LB&I will ensure that alternative treatments are actually implemented.

62 IRM 4.32.1 (June 5, 2014); IRS response to TAS information request (July 13, 2016).

63 See National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*).

64 In her 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that “... provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance,” which she has updated in subsequent reports. See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface); National Taxpayer Advocate 2015 Annual Report to Congress xvii-xxiii (Taxpayer Rights Assessment: *IRS Performance Measures and Data Relating to Taxpayer Rights*).

The IRS could routinely estimate the effect of alternative treatments on “service revenues,” voluntary compliance, and the views of narrow taxpayer segments.<sup>65</sup> Some proxies for measuring the effect of alternative treatments on voluntary compliance are:

- On-time filing and payment rates;
- The percentage of returns with unexplained discrepancies (*e.g.*, mismatches and math errors);
- The IRS’s estimate (as measured by the Discriminant Index Function or other screens) of the amount of underreporting it would find if it audited the segment’s returns;
- Changes to income or deductions actually reported on subsequent returns as compared to appropriate benchmarks or control groups; and
- Satisfaction with and trust for the agency.<sup>66</sup>

Standard examinations (and compliance checks) could be used, in large part, to educate specific taxpayers and identify areas of noncompliance that need to be addressed more broadly and systemically through coordination with the IRS’s other functions, including through education and outreach.

## CONCLUSION

The IRS’s functional organization does not empower employees or business units to find creative ways to prevent noncompliance by collaborating with other functions or using alternative treatments, even if doing so would be more efficient and effective. However, one premise of the IRS’s Future State plan is “to provide [taxpayers] the services they need in the way that works for them.”<sup>67</sup> This presents an opportunity for the IRS to increase the links between functions and embrace the end-to-end service concept.

Luckily, some of the initial benefits of centralization — efficiency in processing calls and correspondence — can now be achieved by leveraging technology instead. Today, calls can be routed anywhere, 88.2 percent of the individual returns received during the 2016 filing season were filed electronically, and the IRS’s Future State plan is to establish more digital communication with taxpayers.<sup>68</sup> As a result, the IRS has more freedom to decentralize and empower highly skilled multi-functional groups of employees in local offices to better understand their customers where they work and live. The IRS should give them more autonomy, discretion, and incentives to cut across functional lines to identify systemic solutions and help customers, rather than asking them to be uncreative cogs in a centralized processing and enforcement machine.

65 See Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*.

66 Voluntary compliance is correlated with trust for the IRS. See, *e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

67 IRS, *Future State Initiative* (Feb. 22, 2016), <https://www.irs.gov/uac/Newsroom/Future-State-Initiative>.

68 IRS, *Filing Season Statistics for Week Ending May 13, 2016* (May 19, 2016), <https://www.irs.gov/uac/newsroom/filing-season-statistics-for-week-ending-may-13-2016> (reporting individual filings received); Pub. 3415, *The Electronic Tax Administration Advisory Committee’s June 2016 Annual Report to Congress* 4 (June 2016) (Table 2) (discussing the future state plan and projecting 152,825,688 out of 195,931,400 returns would be e-filed for calendar year 2016), <https://www.irs.gov/pub/irs-pdf/p3415.pdf>. It could achieve consistency by increasing the transparency of its procedures by incorporating them into the IRM.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Remove service-wide functions from W&I by establishing a new unit that handles service wide functions (*e.g.*, submission processing, media and publications, etc.) so that W&I can focus on providing end-to-end service to W&I taxpayers, as previously recommended.<sup>69</sup>
2. Establish cross-functional units that have true end-to-end responsibility and accountability for voluntary compliance (*e.g.*, on-time filing and payment rates), satisfaction with, and trust for the agency by narrow taxpayer segments that they can affect, such as those shown in Figure 1.3.1.
3. Establish procedures that require the ODs to implement alternative treatments to address the root causes of noncompliance for a segment or issue (*e.g.*, using multi-functional CIPs, campaigns, or similar programs) before applying coercive treatments, except when it is clear that alternative treatments would be ineffective.

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69 See National Taxpayer Advocate 2010 Annual Report to Congress 49, 70 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding Its Ability to Serve Its Core Base of Individual Taxpayers Effectively*).

MSP  
#4**GEOGRAPHIC FOCUS: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Debra Holland, Commissioner, Wage and Investment Division  
 Sunita Lough, Commissioner, Tax Exempt and Government Entities Division  
 Douglas W. O'Donnell, Commissioner, Large Business and International Division  
 Donna C. Hansberry, Chief, Appeals

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM<sup>2</sup>**

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) required the IRS to replace its geographic-based structure with organizational units serving specific groups of taxpayers.<sup>3</sup> In doing so, the importance of having a local, engaged presence in taxpaying communities was minimized. Instead of communicating with IRS employees who understand the needs and conditions of a specific geographic economy or community, taxpayers often interact with IRS employees who lack this knowledge.

The National Taxpayer Advocate has long emphasized the importance of the IRS maintaining a local presence in both service and compliance operations.<sup>4</sup> Voluntary tax compliance relies heavily on taxpayer

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.

3 Internal Revenue and Restructuring Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998) (codified at IRC § 7801). For more information and a detailed discussion of IRS Structure, see Most Serious Problem: *IRS Structure: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *supra*.

4 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45; National Taxpayer Advocate 2014 Annual Report to Congress 46-54; National Taxpayer Advocate 2014 Annual Report to Congress 311-14; National Taxpayer Advocate 2012 Annual Report to Congress 302-18; National Taxpayer Advocate 2010 Annual Report to Congress 267-77; National Taxpayer Advocate 2008 Annual Report to Congress 95-113; National Taxpayer Advocate 2007 Annual Report to Congress 162-82; National Taxpayer Advocate 2005 Annual Report to Congress 2-24; National Taxpayer Advocate 2004 Annual Report to Congress 8-25.



discretion, integrity, and honesty.<sup>5</sup> A local presence in the community better equips the IRS to improve tax morale by encouraging voluntary compliance, creating a culture of compliance, and influencing prevailing social views in a geographic region.

The National Taxpayer Advocate is concerned that:<sup>6</sup>

- A lack of geographic presence can have a negative effect on taxpayer morale, which in turn may decrease voluntary compliance and increase taxpayer burden;
- The absence of a geographic footprint deprives the IRS and taxpayers of local knowledge which may result in missed opportunities to meet taxpayers' unique needs, and to identify and address noncompliance specific to a geographic region; and
- The IRS is slow to find innovative ways to maintain and create local presence in communities.

The overriding purpose of tax administration is to enable voluntary compliance which can be significantly furthered by providing service, creating a culture of trust, and promoting an understanding of the role taxes play “in a civilized society.”<sup>7</sup> Failing to maintain a robust geographic presence hinders the IRS's ability to achieve its mission.<sup>8</sup>

## ANALYSIS OF PROBLEM

### Background

Prior to 1998, the IRS served every taxpayer at one of ten centralized IRS service centers and 33 local district offices.<sup>9</sup> Each district director assigned taxpayer education programs to the examination or collection functions within their districts.<sup>10</sup> RRA 98 required the IRS to give organizational units end-to-end responsibility for providing service to specific taxpayer population segments.<sup>11</sup> After RRA 98, the IRS created national operating divisions (ODs) named after four taxpayer segments: Wage and Investment (W&I), Small Business/Self-Employed (SB/SE), Tax Exempt and Government Entities (TE/GE), and Large and Mid-Sized Business (LMSB), later renamed Large Business and International (LB&I).<sup>12</sup>

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- 5 For a detailed discussion on behavioral research, see Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra* and Literature Review: *Behavioral Science Lessons for Taxpayer Compliance*, *infra*. See also Maria Sigala, Carole B. Burgoyne & Paul Webley, *Tax Communication and Social Influence: Evidence from a British Sample*, 9 J. OF CMTY. & APPLIED SOC. PSYCHOL. 237, no. 3 (1999). See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-55 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*). A recent TAS Research study on compliance factors identified a link between salient relationships, *i.e.*, one's membership in a group, and one's own attitudes and behaviors towards tax and compliance.
- 6 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.
- 7 *Compania General De Tabacos De Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).
- 8 See, e.g., IRS Pub. 3349, *Modernizing America's Tax Agency* (Feb. 1999).
- 9 S. REP. No. 105-174, at 9 (1998); J. Comm. on Tax'n (JCT), *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 16-17 (1998); IRS Pub. 3349, *Modernizing America's Tax Agency* 1-10 (Apr. 2000), <https://www.irs.gov/pub/irs-utl/27877d00.pdf>.
- 10 Internal Revenue Manual (IRM) 22.30.1.1.2 (Jan. 1, 2002).
- 11 RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998); JCT, *General Explanation of RRA 98*, JCS-6-98, 17 (1998).
- 12 For a more detailed discussion of the lack of IRS cross-functional cooperation and end-to-end service, see Most Serious Problem: *IRS Structure: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *supra*.

Legislators believed that increasing the IRS's focus on customer service would improve voluntary compliance by promoting public confidence in the IRS.<sup>13</sup> However, the IRS has interpreted congressional directives narrowly by shifting more work from highly-trained field employees to lower-graded campus employees who have less authority and are assigned narrower issues and mechanical tasks.<sup>14</sup>

**FIGURE 1.4.1, Locations With Specified Employees in the Last Pay Period of the Fiscal Year<sup>15</sup>**

| Number of Locations, Employees, or Visitors                              | 2011   | 2012   | 2013   | 2014  | 2015  | 2016  |
|--|--------|--------|--------|-------|-------|-------|
| IRS Offices (Cities)   | 541    | 523    | 510    | 499   | 479   | 470   |
| Appeals Officers (AOs)   | 1,129  | 1,058  | 958    | 881   | 795   | 739   |
| Revenue Officers (ROs)   | 4,402  | 4,035  | 3,703  | 3,441 | 3,191 | 3,072 |
| Revenue Agents (RAs)   | 11,959 | 11,258 | 10,502 | 9,776 | 9,090 | 8,871 |
| Stakeholder Liaison Outreach Employees                                   | 137    | 123    | 119    | 110   | 105   | 98    |
| Stakeholder Partnerships, Education and Communication Outreach Employees | 522    | 475    | 444    | 405   | 386   | 365   |
| Taxpayer Assistance Centers (TACs)                                       | 401    | 401    | 398    | 382   | 378   | 376   |
| TAC Service Reps   | 1,639  | 1,515  | 1,484  | 1,520 | 1,423 | 1,267 |

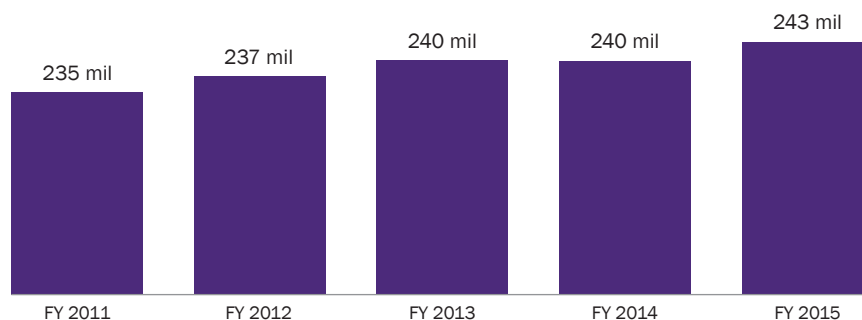
At the same time, taxpayer returns filed increased between tax year (TY) 2011 and TY 2015. Overall, filings grew nearly four percent from nearly 235 million in TY 2011 to over 243 million in TY 2015.<sup>16</sup>

13 See, e.g., JCT, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (1998) (“the Congress believed that most Americans are willing to pay their fair share of taxes, and that public confidence in the IRS is key to maintaining that willingness.”).

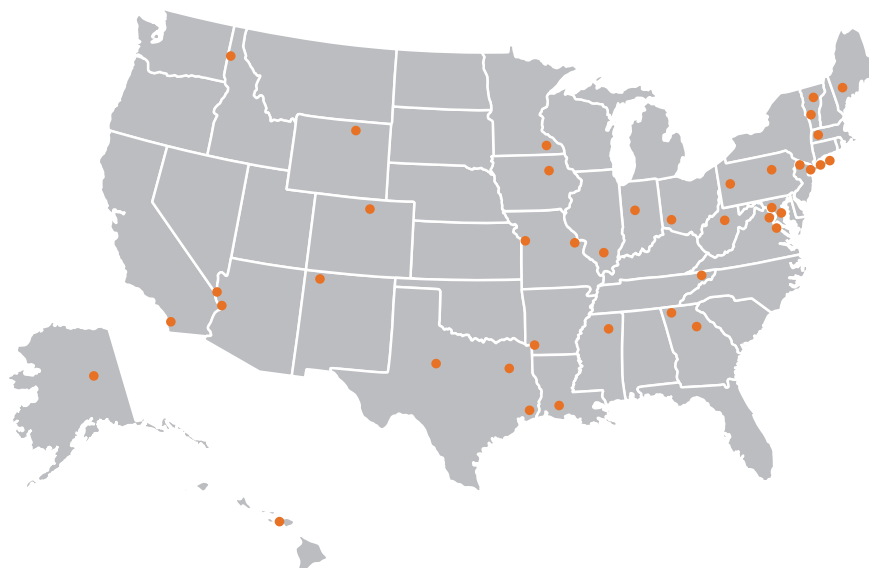
14 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 134-44; National Taxpayer Advocate 2014 Annual Report to Congress 145-53; National Taxpayer Advocate 2014 Annual Report to Congress 123-33.

15 Figures for Appeals Officers, Revenue Officers, Revenue Agents, Stakeholder Liaison Outreach, Stakeholder Partnerships, Education and Communication Outreach, and Taxpayer Assistance Center (TAC) Service Representatives are from the IRS response to TAS Fact Check (Dec. 16, 2016). TAC customer service representative figures are from the IRS Human Resources Reporting Center *Position Report by Employee Listing for the ending pay period for FY 2011 to 2016*, <https://persinfo.web.irs.gov/>. The IRS response to TAS Fact Check (Dec. 16, 2016) showed the following counts for TAC customer service representative: Fiscal Year (FY) 2011 – 1,977, FY 2012 – 1,839, FY 2013 – 1,775, FY 2014 – 1,803, FY 2015 – 1,678, and FY 2016 – 1,477. TAS was unable to replicate the IRS TAC employee figures, and information was not provided by TAC employee location (city) to update the Figure 1.4.3, *Assistance Centers With Employees in 2011 But Without Employees by 2016*. TAC Office figures for FYs 2011-2014 from IRS response to TAS Fact Check (Dec. 23, 2014). TAC Office figures for FY 2015 from W&I analyst (Dec. 13, 2016). TAC Office figures for FY 2016 from the IRS response to TAS Fact Check (Dec. 20, 2016).

16 IRS, *Databook Returns Filed Tax Year (TYs) 2011-2015*, Nov. 30, 2016.

**FIGURE 1.4.2**<sup>17</sup>**U.S. Tax Returns Filed, FYs 2011-2015**

Not only has the IRS moved employees from local offices to campuses, it has also decreased the number of Taxpayer Assistance Centers (TACs) (also known as walk in sites) from 401 to 376 (six percent) since 2011.<sup>18</sup> Additionally, 22 TACs have no staff and 95 have only one employee.<sup>19</sup> TAS review of IRS human resources reports found that at least 40 TAC locations that had customer service representatives in 2011 did not have these employees by 2016, as illustrated in Figure 1.4.3.

**FIGURE 1.4.3**<sup>20</sup>**Taxpayer Assistance Centers With Employees in 2011 But Without Employees by 2016**

<sup>17</sup> IRS, Databook *Returns Filed Tax Year (TYs) 2011-2015*, Nov. 30, 2016.

<sup>18</sup> In 2011, the IRS operated 401 TACs. IRS response to TAS information request (Dec. 23, 2014). Today the IRS operates 376 TACs, a reduction of six percent. IRS response to TAS Fact Check (Dec. 20, 2016).

<sup>19</sup> IRS response to TAS Fact Check (Dec. 20, 2016).

<sup>20</sup> IRS Human Resources Reporting Center, Nov. 29, 2016.

### A Lack of Geographic Presence Can Have a Chilling Effect on Taxpayer Morale, Which Decreases Voluntary Compliance and Increases Taxpayer Burden

A growing body of research on the concept of “tax morale” and an individual’s inherent motivation to pay taxes continues to focus on the psychological factors that drive compliance.<sup>21</sup> Research shows that tax compliance is affected by social and personal norms such as those regarding procedural justice, trust, belief in the legitimacy of the government, reciprocity, altruism, and identification within the group.<sup>22</sup> Each of these factors interacts with and is influenced by the others.<sup>23</sup>

In 2012 and 2013, TAS developed and administered a survey to a national sample of sole proprietors to determine the factors that influence compliance behavior in this population.<sup>24</sup> TAS also identified geographic communities where a disproportionate number of taxpayers were deemed to be either high or low compliant taxpayers. The studies found that respondents from low-compliance communities were suspicious of the tax system and its fairness. Those in the low-compliance group were clustered in geographic communities while those in the high-compliance group were more dispersed. The low-compliance group also reported more participation in local institutions. The research identified a link between the salient relationships, *i.e.*, one’s membership in a group, and one’s own attitudes and behaviors towards tax and compliance. Local norms were the most influential factors of tax compliance.<sup>25</sup> The research suggests the IRS should retain a local presence and conduct targeted outreach and education events, particularly in low-compliance communities.

A lack of geographic presence may have a chilling effect on taxpayer morale, which in turn may decrease voluntary compliance contributing to the growth of the “shadow economy.”<sup>26</sup> Without access to local IRS employees, taxpayers may turn to both legitimate and illegitimate internet resources for tax information, where anonymity provides cover for behavior people might not normally consider. Psychological research has shown that “anonymity increases unethical behavior” and that “in the online world, which can offer total anonymity, the effect is even more pronounced” with “[p]eople — even ordinary, good people

- 21 Eva Hofmann, Erik Hoelzl, & Erich Kirchler, *Preconditions of Voluntary Tax Compliance: Knowledge and Evaluation of Taxation, Norms, Fairness, and Motivation to Cooperate*, 216 Z PSYCHOL. No. 4, 209–17, (2008). For a detailed discussion on behavioral research, see Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra* and Literature Review: *The IRS Is Missing Opportunities to Leverage Behavioral Science Insights and Measure Service Revenues, infra*. See The Netherlands Tax and Custom Administration, *Horizontal Monitoring Within the Medium to Very Large Business Segment*, (Nov. 30, 2010) for an example of a tax agency incorporating the concepts of mutual trust and transparency to build rapport with the taxpayers it serves.
- 22 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*).
- 23 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 1-14 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*) (finding small businesses subject to an accuracy-related penalty had lower subsequent compliance if the penalty was assessed by default, was abated, or was appealed, potentially suggesting that penalties perceived as unfair reduce future compliance); Norman Gemmell and Marisa Ratto, *Behavioral Responses to Taxpayer Audits: Evidence From Random Taxpayer Inquiries*, 65 NAT. TAX J. No. 1, 33–58, (Mar. 2012) (suggesting that audits of compliant taxpayers may reduce voluntary compliance); National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 67-100 (*Audit Impact Study*) (finding taxpayers who were audited but did not receive an additional assessment reduced their reported income following an audit).
- 24 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 60-61 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).
- 25 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-55 (Small Business Compliance: *Further Analysis of Influential Factors*).
- 26 Also called the underground, informal or parallel economy, the shadow economy includes not only illegal activities but also unreported income from the production of legal goods and services, either from monetary or barter transactions. See Friedrich Schneider with Dominik Enste, *Hiding in the Shadows: The Growth of the Underground Economy*, Economic Issues No. 30 (Int’l Monetary Fund, Mar. 2002), <http://www.imf.org/external/pubs/ft/issues/issues30/>.

— often chang[ing] their behavior in radical ways.”<sup>27</sup> Taxpayers may become convinced that avoiding taxes is the social norm and may act accordingly in regards to their obligations.

### **The Absence of a Proper Geographic Footprint Deprives the IRS and Taxpayers of Local Knowledge Which May Result in Missed Opportunities to Meet Taxpayer Service Needs and to Identify and Address Noncompliance Specific to a Geographic Region**

Post-RRA 98, the IRS shifted its community based resources to campuses relying on national “one-size-fits-all” service and compliance policies for each category of taxpayer. This centralization has resulted in the IRS not addressing the particular attributes of local taxpayer populations and disregarding their *rights to quality service and to a fair and just tax system*. Additionally, service and compliance initiatives designed at the national level may vary in effectiveness across geographic lines.

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Research identified a link between the salient relationships, *i.e.*, one’s membership in a group, and one’s own attitudes and behaviors towards tax and compliance. Local norms were the most influential factors of tax compliance. The research suggests the IRS should retain a local presence and conduct targeted outreach and education events, particularly in low-compliance communities.

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Reductions in IRS geographic presence permeate the entire organization. Twelve states and the territory of Puerto Rico lack a permanent Appeals presence, leaving taxpayers in these states to either wait for a circuit riding employee to visit their area or to travel to the nearest state with an Appeals presence to obtain an in-person hearing.<sup>28</sup> Additionally, 16 states and Puerto Rico lack a Settlement Officer, who hears collection appeals.<sup>29</sup> The IRS consolidated 33 geographically dispersed lien units into a single centralized unit in 2005, virtually eliminating taxpayers’ ability to walk in and obtain an immediate release of a lien.<sup>30</sup> Localized outreach and education have all but disappeared. For example, SB/SE, which serves approximately 62 million taxpayers, has no outreach and education employees in 14 states, plus the District of Columbia.<sup>31</sup>

### ***The Uniqueness and Complexity of a Tax Experience Suggests a Continuing Need for Face-to-Face Interaction***

The National Taxpayer Advocate has long advocated that the IRS should provide service that meets taxpayer needs and provide

27 Julie Zhuo, *Where Anonymity Breeds Contempt*, N.Y. TIMES, Nov. 29, 2010, [http://www.nytimes.com/2010/11/30/opinion/30zhuo.html?\\_r=0](http://www.nytimes.com/2010/11/30/opinion/30zhuo.html?_r=0).

28 Appeals response to TAS information request (June 6, 2016). The states that lack a permanent Appeals Officer are Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont, and Wyoming. There is no permanent Appeals office in the territory of Puerto Rico. For a detailed discussion of the Appeals Future State plans, see Most Serious Problem: *Appeals: The Office of Appeals’ Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its “Future Vision” Should Incorporate Those Values*, *infra*. IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

29 Appeals response to TAS information request (June 6, 2016). IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

30 Government Accountability Office (GAO), GAO 05-26R, *Opportunities to Improve Timeliness of IRS Lien Releases* (Jan. 10, 2005).

31 IRS response to TAS Fact Check (Dec. 15, 2016). IRS Human Resources Reporting Center, *Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees as of the week ending October 1, 2016* (Dec. 1, 2016) (14 states include Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, Wisconsin, and Wyoming).

taxpayers with the necessary tools to comply with their tax obligations.<sup>32</sup> A taxpayer's willingness and ability to use a certain service, such as the internet, mobile applications, phone, or face-to-face services will influence the service a taxpayer actually uses.<sup>33</sup> When it is clear a taxpayer cannot use a particular service, the IRS must ensure the taxpayer is provided alternative channels. In particular, it must continue to provide service to taxpayers who do not use the internet.<sup>34</sup> The IRS cannot ignore the 13 percent of the population that does not use the internet while it moves forward with offering more services online and fewer face-to-face services.<sup>35</sup> Service delivery — the provision of assistance to taxpayers in the manner they require in order for them to comply with their tax obligations — should be the primary tenet of tax administration around which all functions are organized.

*The IRS Can Look to the Financial Industry for Models of Presence in Local Communities and Should Seek Local Community Partners*

Individuals “feel more at ease when speaking with local representatives who fully understand their language and idiomatic expressions.”<sup>36</sup> Local management provides “leaders who are completely familiar with the local business environment, culture, and legal climate.”<sup>37</sup> As “one of the world's largest financial institutions”<sup>38</sup> that touches the lives of millions every year, the IRS should study and learn from literature on effects of geographic expansion on bank efficiency.<sup>39</sup> For example, “making relationship loans to borrowers that do not qualify for credit scoring because of a relatively weak financial statements and collateral of questionable value requires local knowledge that is difficult to quantify and transmit to a distant headquarter,” and this “local knowledge” does not only include financial information, but information about “managers, its local environment, and its relationship with customers, suppliers, and local competition.”<sup>40</sup>

One good example of community involvement is the Department of Justice (DOJ) community policing program that involves public-private partnerships between law enforcement and the communities it serves to collaboratively resolve problems and build community trust.<sup>41</sup> The IRS can and should be able to build partnerships with local organizations. It already has a network of Volunteer Income Tax

32 See National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, at 114; National Taxpayer Advocate 2005 Annual Report to Congress 13-15; National Taxpayer Advocate 2004 Annual Report to Congress 49. See also *Internal Revenue Service FY 2008 Budget Request: Hearing Before the S. Comm. on Appropriations Subcomm. on Financial Services and General Government*, 110th Cong., 7-10 (2007) (statement of Nina E. Olson, National Taxpayer Advocate).

33 See National Taxpayer Advocate 2007 Annual Report to Congress 162-82 (Most Serious Problem: Service At Taxpayer Assistance Centers).

34 Pew Research, *Americans' Internet Access: 2000-2015* (June 2015) <http://www.pewinternet.org/2015/12/21/home-broadband-2015/>. For an analysis of taxpayer ability and willingness to use certain service channels, see Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol.2, *infra*.

35 Pew Research, *13% of Americans don't use the internet. Who are they?* (Sept. 2016) <http://www.pewresearch.org/fact-tank/2016/09/07/some-americans-dont-use-the-internet-who-are-they/>. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 56-63.

36 David Ingram, *The Advantages of Geographical Organizational Structure*, HOUSTON CHRONICLE, <http://smallbusiness.chron.com/advantages-geographical-organizational-structure-717.html> (last visited Oct. 1, 2016).

37 *Id.* For an extended literature review related to this topic see Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.

38 IRS, *Resources Home*, <https://jobs.irs.gov/resources> (last visited Dec. 4, 2016).

39 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.

40 See Allen N. Berger, *The Effects of Geographic Expansion on Bank Efficiency* (2000).

41 See, e.g., U.S. Department of Justice (DOJ), FY 2017 Performance Budget, Office of Community Oriented Policing Services (COPS Office), Congressional Justification (Feb. 9, 2016) (discussing the concept of community policing or building partnerships between law enforcement and local communities).



Assistance (VITA) sites, Tax Counseling for the Elderly sites, and Low Income Taxpayer Clinic sites with relationships with local communities. The IRS could expand these partnerships to increase its grassroots outreach and education as well as its involvement in local communities.

### The IRS Is Slow in Finding Innovative Ways to Foster Local Presence in Communities

#### *The IRS Should Consider Partnering With Private and Non-Profit Service Organizations to Increase Its Grassroots Presence and Improve Service to Remote Populations*

It is not always physically or financially feasible to permanently assign employees to the most remote parts of the United States. In these instances, the IRS can partner with private and non-profit organizations to visit these most remote regions and provide tax education and preparation to its taxpayers, many of whom are small businesses or self-employed, or are individuals who rely on tax refunds to provide for their families by claiming credits such as the Earned Income Tax Credit, Child Tax Credit, and other refundable credits.<sup>42</sup>

One example of a successful IRS non-profit partnership is The Alaska Business Development Center, Inc. (ABDC)<sup>43</sup> Volunteer Tax and Loan Program (VTLP). In Alaska, there are more than 100 small remote villages each with fewer than 1,000 residents.<sup>44</sup> There are no TACs or VITA programs in these areas and the geographic location and financial wherewithal of these resident taxpayers make it virtually impossible to visit the closest location for assistance. The ABDC's volunteers travel directly to rural Alaskan communities to provide hands on assistance to those in need.<sup>45</sup> All volunteers complete IRS VITA training "as well as additional ABDC designed training, which details program and Alaska-specific issues."<sup>46</sup> Services are brought to the villages during the tax season to provide free one-on-one assistance and education on taxpayer rights and responsibilities.<sup>47</sup> The IRS should expand this type of partnership to more remote communities throughout the country.

#### *TACs and VITA Programs Provide a Human Element and Help Evoke a Cooperative Relationship Between Taxpayers and the IRS*

TACs provide more than just information to taxpayers. For many taxpayers, the filing of a tax return is the largest monetary transaction they complete each year. It is a complex transaction where mistakes can be financially disastrous for taxpayers. If a taxpayer does not have the proper tools or wherewithal to file a return, that could be the difference between filing (and filing correctly with assistance), or not filing and triggering IRS assessment and collection proceedings.

42 Chuck Marr, Chye-Ching Huang, Arloc Sherman, and Brandon DeBot, *EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds, Center for Budget and Policy public Priorities* (Oct. 1, 2015), <http://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens>.

43 Alaska Business Development Center (ABDC) is a 501(c)(3) nonprofit corporation that provides business consulting and tax-related services to rural Alaskan residents. Founded in 1978, ABDC provides assistance to individuals who do not have access to professional services due to their income, language barriers or isolated geographic location.

44 *Alaska Very Small Towns and Villages (fewer than 1000 residents)*, <http://www.city-data.com/city/Alaska3.html#ixzz4GwkU5eqy>, <http://www.city-data.com/city/Alaska3.html>.

45 ABDC, <http://www.abdc.org/>.

46 Manny Boitz, *Volunteer Tax & Loan Program Celebrates 20 Years Alaska Business Development Center Helps Bring Millions Back to Rural Communities*, ALASKA BUSINESS MONTHLY, (Feb. 2015), <http://www.akbizmag.com/Alaska-Business-Monthly/February-2015/Volunteer-Tax-Loan-Program-Celebrates-20-Years/>.

47 *Id.* In FY 2014, VTLP teams traveled to 80 rural villages and assisted an additional 49 more through the Anchorage Mail-in Site; assisted over 9,100 taxpayers to include more than 1,000 elders aged 60 years or older and over 1,000 commercial fishing captains, crew members, and industry workers; prepared in excess of 4,800 tax returns and delivered nearly 1,400 education presentations; generated over \$6.9 million in tax refunds for rural Alaskan residents; and captured nearly \$2.7 million in the EITC.



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... The IRS shifted its community based resources to campuses relying on national “one-size-fits-all” service and compliance policies for each category of taxpayer. This centralization has resulted in the IRS not addressing the particular attributes of local taxpayer populations and disregarding their *rights to quality service and to a fair and just tax system*.

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TACs play an important role in meeting the needs of underserved taxpayers, including rural, elderly, disabled, English as a second language, American Indian, and low income taxpayers. The National Taxpayer Advocate is concerned that the IRS’s focus on online services will leave these vulnerable populations behind.<sup>48</sup>

As part of its service changes for fiscal year (FY) 2014, the IRS eliminated return preparation at all TACs and redirected taxpayers to volunteer sites and Free File.<sup>49</sup> Despite unprecedented service reductions, taxpayer demand for face-to-face service at the IRS’s walk-in sites has remained high — above 2.5 million visits by June 2016.<sup>50</sup> That same period, 95 TACs were staffed by only one employee.<sup>51</sup> The IRS has now converted all TACs to appointment only services.<sup>52</sup> The IRS justifies the closure of TACs and reduction in other services by the lack of need, as based on taxpayer responses to surveys, some of which are conducted entirely online, which may exclude those taxpayers most in need of the services due to lack of internet access.<sup>53</sup> Failing to accurately survey the taxpayers who actually use the TACs, and are in greatest need of these services, creates a self-fulfilling justification that taxpayers do not need or want TACs and therefore the IRS can close them due to decreased demand. Shifting to “by appointment only,” the IRS ignores the way many taxpayers take care of their tax responsibilities.

TAS and W&I have collaborated on the development of a ranking methodology, the Service Priorities Project (SPP), for the major taxpayer service activities offered by W&I. The methodology will take taxpayer needs and preferences into account while balancing them against the IRS’s need to conserve limited resources. TAS has been conducting a phone survey on taxpayer needs and preferences to fill in the available data to make the tool as effective as possible in representing the varying needs of taxpayer populations while addressing the gaps created by data collected only online.<sup>54</sup>

The National Taxpayer Advocate is pleased with the IRS’s initiative to co-locate IRS offices with Social Security Administration offices.<sup>55</sup> Continued expansion of this program, coupled with the creation of virtual service terminals hosted by community partners, will help the IRS reach taxpayers in remote and other underserved communities in a cost-effective manner. The National Taxpayer Advocate encourages

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48 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 56-63.

49 National Taxpayer Advocate 2014 Annual Report to Congress 11.

50 IRS response to TAS Fact Check (Dec. 20, 2016).

51 *Id.*

52 IRS, *Contact Your Local IRS Office*, <https://www.irs.gov/help-resources/contact-your-local-irs-office> (last visited Nov. 30, 2016).

53 See IRS, *Taxpayer Assistance Center Customer Expectations Survey* (2013). The survey is carried out every three years; the survey for 2016 has been completed and the results are being compiled. See also IRS, *Web-First Conjoint Study Survey Instrument*. For a discussion of these surveys see Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*.

54 For a discussion of understanding taxpayer needs and preferences, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*; for a discussion of the TAS Service Priorities Survey and a report of initial findings, see Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

55 As part of “Customer Assistance, Relationships and Education (CARE) FS 2017 Priorities,” the IRS is “continu[ing] to develop and implement plans that will ensure face-to-face service is available to those taxpayers whose tax compliance issues cannot be resolved through alternative methods.”

the IRS to partner with local government organizations such as departments of motor vehicles and Native American governments to bring service to additional communities.

*Other Tax Administrations' Experiences Suggest That Using Mobile Advisors or Mobile Stations and Vans May Improve IRS Connection With the Communities It Serves*

Tax agencies around the world are researching the ways to improve tax morale and inner motivation to improve compliance and perceptions of the agency.<sup>56</sup> For example, Her Majesty's Revenue and Customs (HMRC) in the United Kingdom has taken an approach to taxpayer service and enforcement that combines the expertise of centralization with the ability to reach taxpayers on a local level.<sup>57</sup> The HMRC approach provides mobile advisors for taxpayers who need face-to-face help. The mobile advisors meet with taxpayers by appointment at a variety of venues, from government and community buildings to a taxpayer's home or business.<sup>58</sup> Chile also uses mobile taxpayer assistance stations to deliver services to remote communities, especially those where taxpayers have no or limited internet access.<sup>59</sup> The National Taxpayer Advocate has recommended on numerous occasions that IRS use mobile vans to reach underserved taxpayer populations.<sup>60</sup>

56 See, e.g., Anders Stridh, Compliance Strategist Swedish Tax Agency (Sweden), *The Strategic Plans and Tax Morale*, 45th Inter-American Center of Tax Administrations (CIAT) General Assembly (2011).

57 Her Majesty's Revenue and Customs (HMRC) News, *HMRC Comes Out of the Office to Support Customers Who Need Extra Help* (Feb. 12, 2014); HMRC, *Issue Briefing: Tackling Tax Evasion* (Jan. 2014).

58 HMRC News, *HMRC Comes Out of the Office to Support Customers Who Need Extra Help* (Feb. 12, 2014), <https://www.gov.uk/government/news/hmrc-comes-out-of-the-office-to-support-customers-who-need-extra-help>.

59 Chilean Tax Agency, *¿Qué Es SII Móvil?*, [http://www.sii.cl/portales/sii\\_movil/que\\_es.html](http://www.sii.cl/portales/sii_movil/que_es.html) (last visited Nov. 28, 2016).

60 See National Taxpayer Advocate 2014 Annual Report to Congress 31-45. See also National Taxpayer Advocate 2010 Annual Report to Congress 267-77. In this Most Serious Problem, that IRS reported that it had tested a mobile van program in 2008, 2009, and 2010 despite previously responding to research requests that it did not have mobile vans. Additionally, the IRS never shared the parameters of this program with the National Taxpayer Advocate so TAS was unable to evaluate the efficacy of the program design. See also National Taxpayer Advocate 2008 Annual Report to Congress 95-113. In this Most Serious Problem, the IRS did not respond at all to the National Taxpayer Advocate's recommendation that the IRS begin a mobile van program.

**FIGURE 1.4.4, Chilean Servicio de Impuestos Internos (Chilean Tax Agency) Mobile Van<sup>61</sup>**



## CONCLUSION

A primary way to build taxpayer trust and confidence, provide taxpayer specific service, and to promote understanding of the tax system is to be a part of the community and to display a desire to work with and educate local taxpayers. Local presence entails developing partnerships between the IRS and the communities it serves to collaboratively resolve problems and build community trust.<sup>62</sup> By maintaining and increasing its community presence, the IRS will be better able to:

- Serve taxpayers on a local level through outreach and education;
- Address compliance problems tied to a specific region or group by developing partnerships with the communities and working collaboratively to resolve problems and build community trust;<sup>63</sup>
- Provide local managers and higher level employees with additional exposure to specific trends that drive compliance in a positive or negative way and enable them to relay those trends to executives for consideration on a national level; and
- Alleviate taxpayer mistrust by providing a human aspect to the agency as a whole where employees either live amongst or interact with taxpayers in their communities on a regular basis.

61 Chilean Tax Agency, *¿Qué Es Sii Móvil?*, [http://www.sii.cl/portales/sii\\_movil/que\\_es.html](http://www.sii.cl/portales/sii_movil/que_es.html) (last visited Nov. 28, 2016).

62 See, e.g., U.S. DOJ, FY 2017 Performance Budget, COPS Office, Congressional Justification (Feb. 9, 2016) (discussing the concept of community policing or building partnerships between law enforcement and local communities).

63 DOJ has developed a “community policing” program since 1994, which provides promising results in reducing crime rates and building trust between the police and local communities. See U.S. DOJ, FY 2017 Performance Budget, COPS Office, Congressional Justification (Feb. 9, 2016) (citing a study that showed that the crime problems targeted by COPS Office grantees “led to a statistically precise drop in crime in subsequent years for four of the seven index crimes.”).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Expand partnerships with private and non-profit organizations, similar to the Alaska Volunteer Tax and Loan Program, to visit most remote and underserved regions and provide tax education and preparation to taxpayers within their communities.
2. Use the SPP model to make decisions on taxpayer services, including the location of TACs.
3. Work with community partners to host virtual service delivery terminals for taxpayers located in remote and otherwise underserved communities.
4. Re-staff Appeals Officers and Settlement Officers locally so that one of each employee is located and regularly available in every state, the District of Columbia, and Puerto Rico.
5. Re-staff local outreach and education positions to bring an actual presence to every state.
6. Provide face-to face service through the use of mobile taxpayer assistance stations (vans) in each state.

MSP  
#5**TAXPAYER BILL OF RIGHTS (TBOR): The IRS Must Do More to Incorporate the Taxpayer Bill of Rights into Its Operations****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Sunita Lough, Commissioner, Tax Exempt/Government Entities Division  
 Douglas O'Donnell, Commissioner, Large Business and International Division  
 Donna C. Hansberry, Chief, Appeals  
 Dan Riordan, IRS Human Capital Officer

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM<sup>2</sup>**

The National Taxpayer Advocate had long called for the IRS to adopt a Taxpayer Bill of Rights (TBOR) to be used as a framework for effective tax administration and for Congress to add the list of fundamental rights comprising the TBOR to the Internal Revenue Code (IRC).<sup>3</sup> The IRS officially adopted the TBOR in 2014, and Congress followed in late 2015 by adding the list of fundamental rights to the IRC.<sup>4</sup> IRC § 7803(a)(3) now states:

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.
- 3 See, e.g., National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration; Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (2013), <https://taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf>.
- 4 IRS, IR-2014-72, *IRS Adopts "Taxpayer Bill of Rights;" 10 Provisions to be Highlighted on IRS.gov*, in *Publication 1*, <https://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights%3B-10-Provisions-to-be-Highlighted-on-IRSGov-in-Publication-1> (June 10, 2014). Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

In discharging his duties, the Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title, including—

This section then goes on to list the ten fundamental rights originally proposed by the National Taxpayer Advocate.

Following the adoption of the TBOR, the IRS embarked on an extensive public outreach campaign. In conjunction with the National Taxpayer Advocate, it revised Publication 1, *Your Rights as a Taxpayer*, to explain the ten rights in plain language.<sup>5</sup> During the 2015 and 2016 filing seasons, the IRS published Special Edition Tax Tips and a series of weekly fact sheets covering each of the ten fundamental rights. The IRS mailed TBOR fact sheets to tax professional organizations and partners, and placed articles in online newsletters.

Although the IRS has commendably done much to make the public aware of the TBOR, it is not fulfilling Congress's mandate in IRC § 7803(a)(3) in a comprehensive or strategic manner.<sup>6</sup> The IRS has declined to incorporate the TBOR into many areas of its operations, maintaining that its materials already include taxpayer rights. Despite being mandated by Congress to ensure that IRS employees are familiar with and abide by taxpayer rights,<sup>7</sup> the following areas represent missed opportunities for the IRS to incorporate the TBOR into its operations:

- Employee training and messaging;
- Employee guidance such as the Internal Revenue Manual (IRM);
- Employee recognition and awards;
- Performance measures, quality measures, and customer satisfaction surveys;
- Mechanisms for holding itself accountable such as the Business Performance Review (BPR) process; and
- Policy decisions and strategic plans for serving taxpayers, including its Future State plans.

The IRS's failure to fully incorporate the TBOR into these areas creates a risk that taxpayer rights will not be fully observed during interactions with taxpayers. For example, appeal rights may be lost or the IRS may fail to consider a taxpayer's unique facts and circumstances. When the TBOR is not fully observed, taxpayers may be harmed and voluntary compliance may decline. This Most Serious Problem will gauge the IRS's progress in operationalizing the TBOR and draw on the lessons learned from other countries' experiences with implementing and adhering to a taxpayer charter.<sup>8</sup>

<sup>5</sup> See IRS Publication 1, *Your Rights as a Taxpayer* (Dec. 2014).

<sup>6</sup> In 2013, the National Taxpayer Advocate issued a report to the Principal Deputy Commissioner of the IRS, outlining how it could use the TBOR as a framework for effective tax administration. This report contained almost two dozen action items for the Taxpayer Advocate Service (TAS) as well as almost two dozen recommendations for the Commissioner of the IRS. While TAS has followed through with what it committed to doing in this report, the IRS has not fulfilled its part. National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration; Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (2013), <https://taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf>.

<sup>7</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

<sup>8</sup> Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.



## ANALYSIS OF PROBLEM

### Employee Training and Messaging Needs to Meaningfully Incorporate the Taxpayer Bill of Rights (TBOR)

#### *Without Guidance From Leadership, Training Materials Incorporate the TBOR Inconsistently and Insufficiently*

In 2015, Congress mandated that the IRS Commissioner “In discharging his duties ... shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title.”<sup>9</sup> This training obligation can be met in several ways — technical training, annual mandatory training, IRM instructions, messages to employees, etc. Although the IRS has incorporated taxpayer rights into some of its training courses,<sup>10</sup> and has disseminated messages to IRS employees emphasizing the importance of observing TBOR, it has not issued any kind of operating division-wide or servicewide guidance specifically on how to incorporate the TBOR into training materials.<sup>11</sup> The Human Capital Office (HCO) reported it would be open to working with TAS to include a preliminary page about TBOR in the training materials for each leadership training course.<sup>12</sup> While helpful, this effort falls short of what is critically needed — to provide consistent and comprehensive directions to all employees who create training on how to incorporate the TBOR throughout their training materials, as required by IRC § 7803(a).

This lack of strategic leadership results in taxpayer rights information being inserted in IRS course materials in a piecemeal and boilerplate manner, with some courses covering taxpayer rights topics with no reference to the fundamental rights adopted by the IRS,<sup>13</sup> other courses sending mixed messages about the TBOR,<sup>14</sup> and still other courses failing to explain taxpayer rights at all.<sup>15</sup> Notwithstanding this lack of

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- 9 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
  - 10 See, e.g., Automated Collection System (ACS) Basic Taxpayer Appeal Rights, Item 18755 (draft version provided to TAS on July 13, 2016); CPE Lesson 6, Taxpayer Rights and Automated Underreporter (AUR) (undated training document provided to TAS on July 13, 2016).
  - 11 The Human Capital Office (HCO) reported that it is working on content for annual ethics discussions and plans to add TBOR information into the New Manager Orientation Program, but the IRS has not provided TAS with any evidence of guidance issued that specifically addresses how to incorporate the TBOR into all training materials. The Small Business/Self Employed (SB/SE) Operating Division stated “SBSE was asked to incorporate TBOR into training in 2014, but we cannot locate that guidance/communication.” IRS response to TAS information request (July 13, 2016).
  - 12 IRS response to TAS information request (July 13, 2016); IRS response to TAS fact check (Dec. 16, 2016).
  - 13 The current ACS course, *Basic Taxpayer Appeal Rights*, never mentions the TBOR by name nor does it cite any of the ten fundamental rights. It references “appeal rights” but never articulates that taxpayers have the *right to appeal an IRS decision in an independent forum*, thus overlooking a key part of this right — the independence of the Office of Appeals or the U.S. Tax Court. IRS, *ACS Basic Taxpayer Appeal Rights*, Item 18755 (draft version provided to TAS on July 13, 2016). The IRS states it is currently updating this training, which will become *ACS New Recruit Course 18755 - Taxpayer Appeal Rights*, and will incorporate the TBOR, the Freedom of Information Act, and other information related to taxpayer rights. IRS response to TAS fact check (Dec. 16, 2016). Another example provided by the IRS references the legislation, TBOR 2, but makes no reference to the TBOR adopted by the IRS and Congress, reflecting a lack of awareness about the difference between prior legislation granting specific rights and the statement of principles adopted by the IRS. IRS response to TAS information request (July, 13, 2016).
  - 14 See Return Integrity & Compliance Services (RICS) Integrity & Verification Operations (IVO), Training 29048-102 (Dec. 2014). This training states, “As an IVO employee, it is also your responsibility to protect the rights of the *good* taxpayer” (emphasis added), implying that only “good” taxpayers have rights. Leaving aside the definitional issues of what, precisely, a “good” taxpayer is, this statement is a false and dangerous generalization because the TBOR rights are guaranteed to *all* taxpayers. They are foundational to the structure of effective tax administration.
  - 15 For example, the Examination Toll-Free Telephone Assistor Training covers topics related to taxpayer rights, such as taxpayer authentication and power of attorney, without discussing the rights and their significance. Exam Toll-Free Telephone Assistor Training Course 12256-102 (Rev. June 2013). This course has not been updated since 2013, despite a prior discussion of its inadequate coverage of taxpayer rights. See National Taxpayer Advocate’s 2013 Annual Report to Congress 53.



direction at a servicewide level, Examination prepared an excellent course on taxpayer rights that could be a model for other IRS courses.<sup>16</sup> This training discusses what the fundamental rights mean and provides examples of how the rights apply in specific situations with references to IRC provisions, Treasury Regulations, Revenue Procedures, and Internal Revenue Manuals (IRMs).<sup>17</sup> Such training should be shared with other IRS functions with guidance to prepare similar training.

*Employee Messaging About the Taxpayer Bill of Rights (TBOR) Should Motivate Employees to Improve the Protection of Taxpayer Rights and Should Be Ongoing*

Employee messaging can communicate TBOR information and help create a shared mindset among employees.<sup>18</sup> During the 2015 filing season, the Small Business/Self Employed (SB/SE) Division sent out a series of six employee emails from the Directors of Collection and Examination.<sup>19</sup> Each email focused on one or two fundamental rights and gave examples of what employees already do each day to recognize these rights. While helpful, this messaging would have been even more beneficial if used to improve the protection of taxpayer rights, as opposed to recognizing what has always been done, and thus merely upholding the status quo.<sup>20</sup>

An email to employees from the Director of Field Collection provides a great example of effective TBOR messaging:<sup>21</sup>

Two important rights in the Taxpayers' Bill of Rights (TBOR) are the Right to be Informed and the Right to Quality Service. These are also closely related to vital "customer satisfaction" measures we monitor. This fiscal year we want to continue to stress the criticality of making sure our customers are aware of the status of their case. Generally, interaction with a field Revenue Officer of the Internal Revenue Service has the potential for adding uncertainty and anxiety in the lives of those we serve. While we must do our best to bring them into voluntary compliance with the tax laws, treating each taxpayer with dignity, respect, and courtesy go a long way in instilling trust in the system. Likewise, periodically letting the taxpayer know where we are in the process of resolving their case gives the customer knowledge about the process and a sense they have a role in the outcome — peace of mind. Please continue to make this effort for the public you serve. This year, Field Collection saw improvement in the Customer Satisfaction measure, "Keeping the Taxpayer up to date on the Collection Process" from 54% satisfied (1st Quarter 2016) to 57% satisfied (2nd Quarter 2016). We also saw improvement in "Courtesy and professionalism of the assigned RO" from 72% to 77% satisfied! However, we still need to improve in "Notifying the TP of case closure" (where we saw a decline from 56% to 55% satisfied). Imagine how you would want to be treated by the IRS, or how you would want your friends and family members treated?

This message focuses on two fundamental rights, connects those rights to specific customer satisfaction measures where results have increased recently, and nudges employees to try to improve other related measures where results have declined.<sup>22</sup> TAS is unaware of similar communications from other IRS

16 IRS, *Taxpayer Rights Self Study Guide*, Fiscal Year (FY) 2014 Exam CPE Training 57089 (undated document provided to TAS on July 13, 2016). This training will be part of the curriculum for new hire revenue agents and tax compliance officers in 2016.

17 *Id.*

18 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

19 IRS response to TAS information request (July 13, 2016) (emails on file with TAS).

20 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

21 IRS response to TAS information request (July 13, 2016).

22 IRS response to TAS information request (July 13, 2016) (email on file with TAS).

managers.<sup>23</sup> Messaging must be ongoing and delivered in a variety of ways, not only in the filing season following the adoption of the TBOR or in a single message from one director. TBOR annual refreshers similar to mandatory briefings currently available on the Enterprise Learning Management System can become yet another example of ongoing messaging.<sup>24</sup> TAS will undertake the development of a TBOR annual training, and work with the IRS Operating Divisions and functions to develop content that is relevant to their work.

### The IRS Has Not Adequately Incorporated the Taxpayer Bill of Rights (TBOR) Into Its Guidance and Written Materials

#### *The IRS Has Provided Little Direction to Employees on How to Incorporate the Taxpayer Bill of Rights (TBOR) into Internal Revenue Manual (IRM) Guidance, Letters, and Notices*

The IRS has provided little guidance to employees responsible for drafting IRMs and taxpayer correspondence that focuses on how to incorporate the TBOR into these materials.<sup>25</sup> In 2016, the National Taxpayer Advocate spoke at the Internal Management Document (IMD) Virtual Conference<sup>26</sup> on how to incorporate taxpayer rights into IRM drafts and reviews.<sup>27</sup> In addition, the Servicewide Policy,

Directives and Electronic Research office sent an email to be distributed to all IRM authors that included boilerplate language advising authors to review and update their content related to the TBOR, without further explanation.<sup>28</sup> More comprehensive training is needed for all employees drafting IRMs and taxpayer correspondence, similar to the training the National Taxpayer Advocate provided to TAS employees.<sup>29</sup> This training used examples of IRM sections negotiated by TAS as well as those with potential for adding TBOR information. The training included best practices and tips for how to identify which fundamental rights apply, how to explain what they mean, and how to apply them to the particular situation.

Until the IRS provides this training or a similar training to its employees, TBOR information will continue to be added inconsistently, if at all. Some IRM sections include a proper discussion of TBOR or a fundamental

This lack of strategic leadership results in taxpayer rights information being inserted in IRS course materials in a piecemeal and boilerplate manner, with some courses covering taxpayer rights topics with no reference to the fundamental rights adopted by the IRS.

- 23 Other examples of TBOR messaging provided by the IRS include a short description of the TBOR in the FY 2016 Exam Program Letter and a token reference to TBOR in the document, SB/SE Examination Operating Unit FY 2015 Priorities. IRS response to TAS information request (July 13, 2016).
- 24 Annual mandatory briefings for all employees include courses on ethics, physical security, information systems security, privacy and disclosure, records management, and section 1204 of the Restructuring and Reform Act of 1998 (RRA 98), which relates to the use of enforcement statistics to evaluate employees and the fair and equitable treatment retention standard. IRS, Mandatory Briefing Timeframes, Mandates & Certification Requirement, <http://e-learning.web.irs.gov/Briefings/docs/Briefings/2016/Mandatory%20Briefing%20Timeframes.pdf> (Nov. 25, 2016). IRM 1.5.2.7, *Restructuring and Reform Act of 1998 (RRA 98) Section 1204* (Jan. 1, 2015).
- 25 See IRS response to TAS information request (July 13, 2016).
- 26 This conference was conducted by the Servicewide Policy, Directives, and Electronic Research Office on May 3, 2016, and this session was intended for all IRM authors and managers.
- 27 TAS representatives also spoke at an Internal Management Document (IMD) Oversight Council meeting in 2015 and requested IRM authors go through their IRMs to see if they needed new or updated references. IMD Oversight Council Meeting Minutes (May 20, 2015).
- 28 Email from Servicewide Policy, Directives and Electronic Research to IMD Coordinators (May 26, 2015) (on file with TAS).
- 29 TAS continues to focus on ensuring employees receive ongoing education in protecting taxpayer rights, tax law and procedures, and on how to advocate effectively for taxpayers. To meet this objective, the National Taxpayer Advocate conducted a webinar training on how to incorporate the TBOR into the IRM, which was viewed by all TAS employees. TAS, *Taxpayer Bill of Rights: Persuasive Writing and Research for IRM Reviews*, [https://www.irsvideos.gov/Presentation?post\\_id=1445](https://www.irsvideos.gov/Presentation?post_id=1445) (Aug. 2015).

right, including how it specifically applies in a situation,<sup>30</sup> but others merely include token references to the fundamental rights<sup>31</sup> or fail to articulate the connection to the TBOR or the fundamental rights at all.<sup>32</sup> In one example provided by the IRS, the IRM states “Taxpayers should receive quality customer service.”<sup>33</sup> This phrasing, instead of a clear “Taxpayers have the right to quality service,” weakens the meaning of the TBOR. Further, even when the IRM does point out a specific action that should be taken by the IRS to properly observe one of the specific rights, the IRM fails to provide any remedy for taxpayers if such action is not taken.

### *The IRS Has Declined to Accept Many of TAS’s Suggestions to Add Taxpayer Bill of Rights (TBOR) References into Its Guidance, Correspondence, and Publications*

Between October 1, 2015 and November 2, 2016, TAS has made 402 recommendations to the IRS, seeking to change guidance, correspondence, or publications to better observe a TBOR right or add a reference to a particular right. The IRS has only adopted 136 (or about 49 percent) of the 280 recommendations that are not currently in process, being monitored, or being negotiated.<sup>34</sup>

An example of one such recommendation not adopted is IRM 25.13.1.3, *Erroneous Correspondence Procedures – Report Erroneous Correspondence Process*, which provides IRS employees with the procedures for reporting any correspondence (*i.e.*, notices, letters, transcripts, faxes, etc.) that was improperly sent to a taxpayer or correspondence that contains errors. This IRM states “All IRS employees are responsible for reporting any case of erroneous taxpayer correspondence (or potential case) to the Office of Taxpayer Correspondence, Data Metrics & Error Resolution (DMER) office through the Report Erroneous Correspondence process.”<sup>35</sup> TAS submitted the following recommended language to help employees understand how this responsibility relates to the TBOR:

Taxpayers have the Right to Confidentiality, which means they can trust that the information they provide to the IRS will not be disclosed unless authorized by the taxpayer or the law. Employees can support this right by reporting erroneous taxpayer correspondence, which may prevent future unauthorized disclosures and build taxpayer trust.

The IRS refused to add this language, or alternative TBOR language, stating:

Not necessary. We have already outlined OTC [Office of Taxpayer Correspondence] areas of responsibility.

30 See, e.g., IRM 4.46.1.4, *Principles of Collaboration* (Mar. 9, 2016).

31 See, e.g., IRM 25.23.1.4, *Identity Theft and the IRS* (Sept. 22, 2016) (stating the TBOR “grants all taxpayers important rights” without more detail). This IRM section was provided as an example from the IRS in response to TAS’s information request.

32 See, e.g., IRM 4.46.3.5.6, *Opening Conference (Meeting) Participants* (Mar. 14, 2016) (discussing who may receive confidential information and warning examiners to be wary of who is in the room, but failing to make the connection to the *right to confidentiality* included in the TBOR). This IRM section was provided as an example from the IRS in response to TAS’s information request.

33 IRM 4.46.1.1, *Introduction* (Mar. 9, 2016). This IRM was provided as an example from the IRS in response to TAS’s information request.

34 The 280 recommendations include recommendations that have been adopted, recommendations that have not been adopted, and recommendations that have been elevated to the TAS Technical Liaison after negotiations between the author and the TAS reviewer were unsuccessful. The remaining recommendations of the 402 are currently in process, being monitored, or being negotiated.

35 IRM 25.13.1.3, *Erroneous Correspondence Procedures – Report Erroneous Correspondence Process* (Oct. 14, 2015).

However, the OTC areas of responsibility in the IRM say nothing about taxpayer rights, and the refusal to include this reminder represents a missed opportunity for the IRS to make taxpayer rights a part of its daily operations, and fails to fulfill the mandate of IRC § 7803(a).<sup>36</sup>

### Including the Taxpayer Bill of Rights (TBOR) in Employee Recognition and Awards Would Reinforce the TBOR As Part of the IRS's Culture

The IRS has multiple award systems for recognizing employee accomplishments. There are various monetary as well as nonmonetary awards presented by managers, heads of office, and the Commissioner of Internal Revenue.<sup>37</sup> The awards vary among their focus — employees can be recognized for exceptional contributions, for “going the extra mile,” for demonstrating a sustained, strong commitment to achieving the strategic objectives, for outstanding strategic thinking and leadership, and for distinguished service, including military, public, and community service.<sup>38</sup> The IRS should create a special award at the Commissioner’s level to encourage employees to protect and support the TBOR, to demonstrate the leadership’s commitment to the TBOR principles, and to ingrain those principles in the IRS’s culture.

### The Taxpayer Bill of Rights (TBOR) Could Be Better Applied In Developing and Reviewing Quality Measures, Performance Standards, and Customer Satisfaction Surveys

The IRS can use the TBOR as a lens through which to view IRS metrics.<sup>39</sup> In response to TAS’s information request, two IRS operating divisions took their quality measurement standards and grouped them according to the relevant TBOR right.<sup>40</sup> While this is a good start, the exercise of assigning different standards to the different rights is not effective unless the results are reported in a similar way so that employees can see which rights are being supported and which require improvement. TAS does this in its “Taxpayer Rights Assessment,” which takes various IRS performance indicators, such as the cycle time to correspond in an identity theft case, and links them to fundamental rights, such as the *right to be informed*.<sup>41</sup> Other IRS offices could similarly use the TBOR to organize their metrics and report success. In addition, TBOR should be used to help create new quality measurements to ensure the IRS is meaningfully measuring adherence to taxpayer rights.

While some IRS offices are effectively incorporating the TBOR into quality and customer satisfaction measures, one area where the IRS seems deficient across the board is in measuring employee performance. The IRS evaluates its employees on a number of critical job elements (CJEs). To TAS’s knowledge, the IRS has provided no guidance to employees on how to incorporate the TBOR into CJEs. Instead, the IRS maintains that several of the CJE components already relate to taxpayer rights, including customer satisfaction and quality of business results.<sup>42</sup> CJE components may include questions that

36 IRM 25.13.1.1, *Overview of Taxpayer Correspondence Services* (Oct. 14, 2015).

37 See, e.g., IRM 6.451.1.9, *Performance Awards* (May 20, 2011); IRM 6.451.1.15, *IRS Employee Recognition Program* (May 20, 2011).

38 IRS internal webpage, <http://hco.web.irs.gov/erp/awards.html> (Nov. 9, 2016).

39 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

40 Both the Large Business & International Division (LB&I) and the Wage & Investment Division (W&I) provided documents to TAS demonstrating how their quality standards reflect the different TBOR rights. IRS response to TAS information request (July 13, 2016). In response to TAS’s fact check, the IRS stated that because TAS did not request a crosswalk of the quality standards and TBOR rights, TAS should “not infer from the IRS response provided that the other IRS BODs [Business Operating Divisions] do not have quality standards that reflect the different TBOR rights.” IRS response to TAS fact check (Dec. 16, 2016).

41 See *Taxpayer Rights Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights*, *supra*. The National Taxpayer Advocate started publishing the Taxpayer Rights Assessment annually in 2014.

42 IRS response to TAS information request (July 13, 2016).

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Based on the IRS response [regarding Future State], the IRS appears to believe the Taxpayer Bill of Rights (TBOR) is not relevant to what capabilities will be required for the Future State (such as the capability for a person to speak with an IRS employee), but is only relevant in prioritizing how to deliver the capabilities it has decided on and in making a post-hoc justification for funding. The IRS disregards taxpayer rights by not considering the TBOR upfront.

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relate to taxpayer rights, such as “Did we provide meaningful outreach to all customers?”<sup>43</sup> However, to truly incorporate the TBOR, the CJs should make the connection between the component and the relevant TBOR rights — the *right to be informed* and the *right to a fair and just tax system*. Linking the desired employee action to a particular right would increase employee awareness of the TBOR and make the employee accountable for observing the TBOR when interacting with taxpayers or working on a taxpayer’s case. The IRS can also use the TBOR as impetus to update and expand existing CJs in order to better evaluate how an employee’s performance supports the TBOR.

Similar to its position regarding CJs, the IRS maintains that existing customer satisfaction survey questions relate to the TBOR, while declining to use the TBOR to inform the creation of additional questions.<sup>44</sup> An Appeals customer satisfaction survey included multiple questions regarding the Alternative Dispute Resolution (ADR) process, asking about general satisfaction, savings in time, savings in money, and whether the taxpayer thought the ADR process and the arbitrator or mediator was impartial.<sup>45</sup> Appeals could use the TBOR to create additional questions, asking not just if the ADR process was impartial, but whether taxpayers felt the ADR mediator was independent from the IRS, part of the *right to appeal an IRS decision in an independent forum*. There may be situations where customers answered affirmatively to certain questions that implicate taxpayer rights, but did not feel that all of their rights were observed. This information could be captured by adding additional questions, such as “Do you feel the IRS observed your right to [insert relevant right]?”, a question that has been posed by other countries in their customer surveys.<sup>46</sup>

### The IRS Should Hold Itself Accountable Through Reporting in the Business Performance Review (BPR)

To make the TBOR more concrete and hold itself accountable, the IRS could implement a program to periodically report on what actions it has taken to further the principles of the TBOR.<sup>47</sup> This could be easily accomplished through the Business Performance Review (BPR) process, which is a quarterly report used to measure and evaluate a division’s performance against established strategic plans, and to share significant accomplishments as well as evolving concerns with the IRS senior leadership.<sup>48</sup> Some BPRs already do report on efforts that advance taxpayer rights. For example, Appeals reported in a recent BPR that it has taken actions to mitigate the risk of negative perceptions of Appeals’ independence.<sup>49</sup> This

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43 IRS response to TAS information request (July 13, 2016).

44 In response to TAS’s information request, LB&I and W&I provided documents to TAS grouping the questions in their customer satisfaction surveys by the TBOR right that is implicated. *Id.*

45 IRS, *FY 2015 Appeals Final Survey Instrument* (2015). For a discussion of the National Taxpayer Advocate’s concerns about Appeals’ ADR program, see Most Serious Problem: *Alternative Dispute Resolution (ADR): The IRS is Failing to Effectively Use ADR As a Means of Achieving Mutually Beneficial Outcomes for Taxpayers and the Government*, *infra*.

46 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

47 See Finance Act 2009, c 10, § 92 (Eng.) (requiring annual reporting on the Her Majesty’s Revenue and Customs (HMRC) charter); HMRC, *Your Charter Annual Report: April 2014 to March 2015* (2016), <https://www.gov.uk/government/publications/your-charter-annual-report-2014-to-2015>. See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

48 IRM 4.46.2.8 *Headquarters Reports* (July 22, 2011).

49 IRS, Appeals Business Performance Review (BPR), Third Quarter – FY 2016 (Aug. 4, 2016).



reporting would be more effective if the BPR grouped together actions and successes that further the TBOR so a function or operating division can clearly see how it is making progress on implementing the TBOR and areas where improvement is needed.

### **The IRS Does Not Provide Evidence That It Considers the Taxpayer Bill of Rights (TBOR) When Making Policy Decisions or Creating Strategic Plans**

#### *Recent Changes to IRS Policy Fail to Adequately Consider TBOR*

The IRS has provided no evidence that it considers the TBOR when creating policies and plans. For example, the Office of Appeals has moved towards a policy of providing appeal conferences by telephone as the default, and only offering in-person conferences under limited circumstances.<sup>50</sup> It appears that Appeals considered some taxpayer rights in coming up with exceptions to this policy. For example, the Appeals employee should consider whether there are numerous conference participants, such that there's a risk of unauthorized disclosure, which relates to the *right to confidentiality*. However, it is not clear Appeals considered how this policy would impact other rights, such as the *right to quality service*. By not providing taxpayers with a method to challenge the denial of a face-to-face conference, the IRS is also infringing on a taxpayer's *right to challenge the IRS and be heard*.

#### *The IRS Does Not Adequately Consider the TBOR in Its Long-Term Plans*

The TBOR is noticeably absent from some of the IRS's long term strategic plans, including its Future State vision.<sup>51</sup> The IRS's Future State webpage includes a passage at the bottom, stating "The Taxpayer Bill of Rights is a foundational component underlying the future vision of the IRS and reflects the agency's ongoing commitment to respecting taxpayer rights. For example, the right to quality service is a central part of these efforts."<sup>52</sup> However, in response to TAS's question regarding how TBOR is being considered and how Future State teams have been instructed to consider TBOR, the IRS acknowledges:

Specific guidance has not been provided to the Groups related to specific requisites, as the groups are currently developing plans on "what" capabilities and functionalities will be needed to attain the envisioned Future State. The "how" to deliver them will be considered once the plans are completed, compiled, and analyzed for their interdependencies, prioritization, and sequencing.<sup>53</sup>

Not including the TBOR in deciding "what" a taxpayer needs will lead to infringements of taxpayer rights. As an example, the IRS has decided that one such need is greater access to taxpayer accounts for third parties like tax return preparers and tax software companies. Such access is intended to compensate for taxpayers for whom online accounts are insufficient. By not considering key taxpayer rights, such as the rights *to be informed*, *to quality service*, *to confidentiality*, and *to a fair and just tax system*, the IRS does not adequately consider that "what" some taxpayers may need is not greater preparer access — which leads

50 See IRM 8.6.1.4.1, Conference Practice (Oct. 1, 2016). For further discussion on Appeals' decision to limit taxpayer's access to face-to-face hearings, see Most Serious Problem: *Appeals: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values*, *infra*.

51 See Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *infra*.

52 IRS, *IRS Future State*, <https://www.irs.gov/uac/newsroom/irs-future-state> (last updated Mar. 4, 2016).

53 IRS response to TAS information request (July 13, 2016).

to increased compliance costs for taxpayers who may prefer to handle their own accounts — but instead alternatives for communicating with the IRS.<sup>54</sup>

The IRS's response regarding the Future State goes on to state that the TBOR will be a requisite to consider when developing business cases for investments.<sup>55</sup> Such post-hoc consideration of the TBOR is clearly inadequate. Based on the IRS response, the IRS appears to believe the TBOR is not relevant to what capabilities will be required for the Future State (such as the capability for a person to speak with an IRS employee), but is only relevant in prioritizing how to deliver the capabilities it has decided on and in making a post-hoc justification for funding. The IRS disregards taxpayer rights by not considering the TBOR upfront.

## CONCLUSION

Congress mandated that the IRS Commissioner “In discharging his duties ... shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title.”<sup>56</sup> In order for the IRS to operationalize the TBOR, it must incorporate it into the daily actions and interactions IRS employees take every day. By not instructing employees to consider and include the TBOR in training, guidance, correspondence, measures, performance appraisals, policy decisions, and strategic plans, the IRS misses opportunities for reinforcing the TBOR as an important part of the IRS's way of doing things. Furthermore, by insisting that the IRS's preexisting practices and materials already recognize taxpayer rights, the IRS avoids using the TBOR as a way to improve the treatment of taxpayers and the protection of their rights.

54 See Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *infra*; Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*.

55 IRS response to TAS information request (July 13, 2016).

56 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Issue guidance at a servicewide level and an operating division-wide level to employees who author training materials, internal guidance, and correspondence with detailed instructions regarding how to incorporate the TBOR into those materials.
2. Collaborate with TAS to create an annual mandatory briefing on the TBOR, which should be designated as mandatory for all employees by the IRS's Human Capital Office.
3. Create an award to be given by the Commissioner of Internal Revenue to recognize special achievements in supporting taxpayer rights and the TBOR.
4. Require operating divisions and functions to report the results of their performance measurements and quality measurements according to the relevant TBOR rights associated with each measure.
5. Update the IRS's guidance for developing CJE's to instruct employees to incorporate the TBOR into the CJE's for all positions.
6. Provide instructions from senior leadership to all Future State teams to consider the TBOR in developing Future State plans and to document how Future State plans affect taxpayer rights.

**MSP  
#6****ENTERPRISE CASE MANAGEMENT (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project****RESPONSIBLE OFFICIALS**

Karen M. Schiller, Assistant Deputy Commissioner for Services and Enforcement  
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Gina Garza, Chief Information Officer, Information Technology

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

As the IRS moves forward with its “Future State” planning,<sup>2</sup> a critical component of this effort will be how it improves its information technology (IT) systems in order to achieve its mission.<sup>3</sup> The IRS's IT challenges are significant and include:<sup>4</sup>

- The two oldest IT systems (each 56 years old) in the entire federal government,<sup>5</sup> and

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- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, 401(a) (2015) (codified at IRC § 7803(a)(3)).
  - 2 TAS is unable to provide its usual comprehensive background data for this Most Serious Problem because in an unprecedented move, the IRS declined to respond to the ECM-related information requested by TAS as part of the Annual Report to Congress process, taking the position that ECM is internal to the IRS and “cannot be categorized as a most serious problem ‘encountered by taxpayers.’” IRS response to TAS research request (Nov. 3, 2016).
  - 3 See, e.g., Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-053, *Taxpayer Online Account Access is Contingent on the Completion of Key Information Technology Projects* (May 2015) (noting that while the IRS has made progress in providing taxpayers with online customer service options, it needs to prioritize the completion of key IT projects that are necessary to provide the electronic platform for developing future projects that will provide taxpayers with dynamic online access capabilities).
  - 4 For an excellent discussion of the IRS's IT challenges, see Zach Noble, *The Taxman's Tech Troubles*, FEDERAL COMPUTER WEEK (FCW) (Apr. 15, 2016), <https://fcw.com/articles/2016/04/08/taxman-tech-troubles.aspx>.
  - 5 See Government Accountability Office (GAO), GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS's Individual Master File (IMF) and Business Master File (BMF) as the two oldest investments or systems at 56 years old each).

- Disparate case management systems ranging between 60 and approximately 200 based on different estimates.<sup>6</sup>

The age, number, and lack of integration across IRS case management systems as well as the lack of digital communication and record keeping cause waste, delay, and make it difficult for IRS employees, including those in TAS, to perform their jobs efficiently. They also create a burden on taxpayers, who must contend with IRS customer service representatives who may not be able to access the records they need to assist taxpayers or must do so on multiple systems. This infringes upon the taxpayers' *right to quality service*.

As a part of its "Future State" vision, the IRS is currently pursuing an IT solution to unify these disparate case management systems through an enterprise case management (ECM) project intended to deal with the issues of automation, records management, and integration. ECM requires a significant investment of both time and money to promote productivity and efficiency gains, and to improve taxpayer service.

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Two of the IRS's systems, according to a recent Government Accountability Office report, are the oldest IT systems (at 56 years old) in the entire federal government.

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TAS understands these challenges, as it is operating with a 1980s legacy system known as the Taxpayer Advocate Management Information System (TAMIS), a system that is largely obsolete and requires case advocates to manually perform many tasks that can and should be automated.<sup>7</sup> For several years TAS worked with the IRS's IT function and a contractor to develop the requirements for an integrated replacement system known as the Taxpayer Advocate Service Integrated System (TASIS), completing around 70 percent of the system programming and spending approximately \$20 million out of a total estimated cost of about \$32 million.<sup>8</sup> However, in March 2014, the IRS halted TASIS citing a lack of funding.<sup>9</sup> This decision impacts taxpayers' *right to a fair and just tax system*, which includes the right to receive assistance from TAS. TAS advocates for taxpayers who are experiencing *significant* hardship and therefore the risk of harm from delay or inefficiency is markedly greater.

The National Taxpayer Advocate is concerned that:

- The IRS is failing to design the ECM project from the ground up to comprehensively engage its employees and seek their suggestions as to how to make processes and procedures more efficient and maximize employee productivity. Without this critical foundational step, the ECM system

<sup>6</sup> See *IRS Legacy Information Technology Systems: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. (2016) (written testimony of Terence Milholland, Chief Technology Officer, IRS) (noting that there are more than 60 aging IRS case management systems), <https://oversight.house.gov/wp-content/uploads/2016/05/2016-05-25-Milholland-Testimony-IRS.pdf>; TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* 22 (Sep. 2016) (noting that the IRS maintains approximately 90 case management systems); Email from Director, Enterprise Case Management (ECM) to all designated ECM Business Unit Point of Contacts, which included the TAS Executive Director, Business Modernization (Mar. 11, 2016) (listing 198 case management systems). IRS response to TAS fact check request (Dec. 16, 2016). See also TIGTA, Ref. No. 2014-20-071, *Information Technology: Improvements Are Needed to Successfully Plan and Deliver the New Taxpayer Advocate Service Integrated System* (Sept. 2014); TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* (Sept. 2014) (both TIGTA reports note "there are more than 200 case management applications in operation across the IRS enterprise").

<sup>7</sup> A legacy system can be defined as an obsolete computer system that may still be in use because its data cannot be changed to newer or standard formats, or its application programs cannot be upgraded, <http://www.businessdictionary.com/definition/legacy-system.html> (last visited Dec. 22, 2016).

<sup>8</sup> *Internal Revenue Service Fiscal Year (FY) 2017 Budget Request: Hearing Before S. Subcomm. on Financial Services and S. General Government Comm. on Appropriations*, 114th Cong. 27 (2016) (statement of Nina E. Olson, National Taxpayer Advocate).

<sup>9</sup> *Id.*

ultimately designed may work well for IT but will not be employee centric and will ultimately adversely impact taxpayers. If the IRS is unable to successfully integrate its 60 to 200 case management systems, then it is unlikely that it will be able to create robust online services to serve taxpayers, thus jeopardizing its “Future State” goals;<sup>10</sup>

- The IRS’s current ECM strategy appears to be inefficient and does not reflect lessons learned from its past case management project failures that, to date, have resulted in abandoned, wasteful, and incomplete initiatives costing tens of millions of dollars; and
- The IRS is failing to leverage the extensive investment of time, money, and effort expended on TASIS in order to incorporate the largely completed elements of TASIS as building blocks for the servicewide ECM solution.

## ANALYSIS OF PROBLEM

### Background

#### *Enterprise Case Management (ECM) in General*

The IRS is currently undertaking an assessment of its case management systems as part of a comprehensive project to create a servicewide ECM solution. The term “case management” is used in a comprehensive sense to refer to electronic recordkeeping systems the IRS uses to track information about interactions with respect to taxpayers’ tax returns or other tax-related matters.<sup>11</sup> These systems include audit and collection case records for individuals and large, medium, and small businesses, exempt organization determinations, whistleblower claims, automated substitutes for returns, the Automated Underreporter Program, criminal investigations, and TAMIS, the TAS case management system.

ECM offers a future vision for consolidated case management that will address the need to modernize, upgrade, and consolidate multiple aging IRS systems. The IRS now supports many of these systems, and although it is unclear precisely how many systems the IRS has, estimates range from more than 60 to approximately 200 systems.<sup>12</sup> As stated above, two of the IRS’s systems, according to a recent Government Accountability Office report, are the oldest IT systems (at 56 years old) in the entire federal government.<sup>13</sup> Few of these systems communicate with one another and none provides an electronic substitute for the paper case file (*i.e.*, there are reams of paper supplementing whatever records

10 See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.

11 Case management can also be referred to as “the process that addresses the resolution of tax administration issues through the management of case creation, execution, maintenance, and closure.” See TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program 22* (Sept. 2016).

12 See *IRS Legacy Information Technology Systems: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. (2016) (written testimony of Terence Milholland, Chief Technology Officer, IRS) (noting that there are more than 60 aging IRS case management systems), <https://oversight.house.gov/wp-content/uploads/2016/05/2016-05-25-Milholland-Testimony-IRS.pdf>; TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program 22* (Sep. 2016) (noting that the IRS maintains approximately 90 case management systems); Email from Director, Enterprise Case Management (ECM) to all designated ECM Business Unit Point of Contacts, which included the TAS Executive Director, Business Modernization (Mar. 11, 2016) (listing 198 case management systems). IRS response to TAS fact check request (Dec. 16, 2016). See also TIGTA, Ref. No. 2014-20-071, *Information Technology: Improvements Are Needed to Successfully Plan and Deliver the New Taxpayer Advocate Service Integrated System* (Sep. 2014); TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* (Sept. 2014) (both TIGTA reports note “there are more than 200 case management applications in operation across the IRS enterprise”).

13 See GAO, GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS’s IMF and BMF as the top two oldest investments or systems at 56 years old each).

are included in the electronic system). The IRS's current case management system structure requires employees to retrieve data from many systems manually, which requires maintaining both paper and electronic records. They must transcribe or otherwise import information from paper and other systems into their own case management systems, and ship, mail, or fax an estimated hundreds of thousands, if not millions, of case management files and supporting documents annually for management approval, quality review, and responses to Appeals and Counsel.<sup>14</sup>

The IRS's former Chief Technology Officer discussed the IRS's ECM goal in recent congressional testimony. He noted:

The IRS intends to further improve compliance programs through investment in an Enterprise Case Management (ECM) system, which is intended to modernize, upgrade, and consolidate more than 60 aging IRS case management systems. This common case management environment will yield efficiencies by implementing standard case management functions, providing the ability to transfer cases between IRS organizations and creating centralized case data accessibility and usability.<sup>15</sup>

### *ECM Is Fundamentally Connected to the “Future State”*

The IRS recognizes the critical importance of ECM to its “Future State,” stating:

The nexus of ECM to Future State is as an enabler of a more flexible workplace whereby an all-electronic case file will be a complete record of a selected case from its inception to closure, including all the tax histories, contacts, communications, actions, etc. The cases could be reassigned if necessary simply by transferring the electronic file, regardless of function or geography — this enables workload balancing and workforce alignment, in addition to enabling a more flexible work environment and more efficient work assignment. It also enables more complete communications with taxpayers and those they authorize to serve them to more readily resolve issues based on the entire tax and case history and all related interactions, so both the taxpayer and employee are working from complete information, including interactions between them from secure messaging and file uploads and downloads for openness and transparency.<sup>16</sup>

In addition, the Commissioner of Internal Revenue has noted “If we can pull off Enterprise Case Management, it would impact so many IRS employees positively and would allow us to make a significant step toward our dealings with taxpayers and the future state.”<sup>17</sup>

### *ECM Is a Taxpayer Issue*

In an unprecedented move, the IRS declined to respond to the ECM-related information requested by TAS as part of the Annual Report to Congress process, taking the position that ECM is internal to the

<sup>14</sup> See National Taxpayer Advocate FY 2017 Objectives Report to Congress 196.

<sup>15</sup> *IRS Legacy Information Technology Systems: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. (2016) (written testimony of Terence Milholland, Chief Technology Officer, Internal Revenue Service).

<sup>16</sup> IRS response to TAS research request (Nov. 3, 2016).

<sup>17</sup> IRS, *Enterprise Case Management Day 4* (Aug. 3, 2016).

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The IRS's current case management system structure requires employees to retrieve data from many systems manually, which requires maintaining both paper and electronic records. They must transcribe or otherwise import information from paper and other systems into their own case management systems, and ship, mail, or fax an estimated hundreds of thousands, if not millions, of case management files and supporting documents annually for management approval, quality review, and responses to Appeals and Counsel.

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IRS and “cannot be categorized as a most serious problem ‘encountered by taxpayers.’”<sup>18</sup> This is contrary to the Commissioner of Internal Revenue’s remarks above and his statement that ECM’s ultimate goal is “better taxpayer service.”<sup>19</sup>

Fortunately for all of us, the IRS isn’t the arbiter of what constitutes a most serious problem for taxpayers — Congress granted that authority to the National Taxpayer Advocate.<sup>20</sup> The National Taxpayer Advocate is disappointed that the IRS refused to provide information about its ECM strategy to TAS and, through the National Taxpayer Advocate’s Annual Report to Congress, to members of Congress. ECM is not internal to the IRS. ECM ties directly into the “Future State” and has an impact on the quality of taxpayer interaction with the IRS, which is essential to voluntary compliance and taxpayer morale.<sup>21</sup> Finally, and more fundamentally, ECM implicates *taxpayer rights*, specifically taxpayers’ *right to quality service*.<sup>22</sup>

### The IRS Has Not Laid the Foundation It Needs for ECM to Succeed

As mentioned above, the IRS’s ECM solution is intended to modernize, upgrade, and consolidate somewhere between 60 and approximately 200 aging IRS case management systems and develop a servicewide solution for performing case management functions using a common infrastructure platform for multiple projects to share across all business units. However, in order to accomplish this mammoth undertaking, it is critical that the IRS undertake the necessary foundational work and build the ECM project from the ground up. Specifically, the National Taxpayer Advocate believes that the IRS should actively and comprehensively engage its employees at the outset of the ECM project, which, as will be described below, is what TAS did when it developed TESIS. IRS employees are the ones that use IRS systems, and understanding their

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18 IRS response to TAS research request (Nov. 3, 2016). As such, TAS was unable to obtain the bulk of the information it sought to prepare this Most Serious Problem. TAS obtained the information used in this Most Serious Problem from external sources and from IRS information outside of the formal Most Serious Problem process.

19 Enterprise Case Management Day 2016, Commissioner Koskinen’s remarks, IRS Newsletter (Oct. 4, 2016), <http://irweb.irs.gov/AboutIRS/Nwsctr/OtherNws/51951.aspx>.

20 See IRC § 7803(c)(2)(B)(ii)(III). With respect to the IRS’s unlawful refusal to provide data and other information required by the National Taxpayer Advocate in furtherance of her tax administration duties, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

21 See Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*. Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.

22 See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).



interaction with those systems and how to make current processes and procedures more efficient is crucial to having a more functional and polished ECM product that will maximize employee productivity. Without this critical foundational step, the ECM system ultimately designed may work well for IT but will not be employee centric and will ultimately adversely impact taxpayers.

However, it appears that the IRS has not reached out to its employees in its current ECM effort. The IRS stated that it asked its employees for work process improvement suggestions during a 2014 realignment between its Small Business/Self-Employed (SB/SE) and Wage and Investment (W&I) divisions.<sup>23</sup> The IRS indicated that it received several employee suggestions noting the need for creating a common case history and providing access to all systems.<sup>24</sup> Soliciting these type of suggestions, particularly from front-line employees and on a larger scale across all business units, is critical to building a solid foundation for ECM.

The National Taxpayer Advocate is supportive of the IRS's efforts to develop a comprehensive ECM solution and believes that proper funding from Congress is needed for this effort to succeed.<sup>25</sup> However, she is concerned about the IRS's ECM planning, particularly its failure to comprehensively engage its employees. The IRS will also benefit from engaging taxpayers and tax professionals to gauge their needs in obtaining quality service from IRS employees. Because ECM will ultimately feed into online accounts, taxpayers and their representatives are important end users.<sup>26</sup> Further, as the IRS is not alone in its need for a large-scale ECM solution, it might benefit from consulting with other federal agencies and international tax agencies about their ECM experiences.<sup>27</sup> However, TAS is unaware of the IRS's attempts to engage taxpayers, tax professionals, or even the majority of future ECM users within the IRS. The National Taxpayer Advocate is concerned that without seeking suggestions from users and intended beneficiaries (*i.e.*, taxpayers), the ECM system developed will likely be rudimentary, cumbersome, and one that falls far short of what the IRS needs to accomplish its "Future State" vision.<sup>28</sup>

23 IRS response to TAS research request (Nov. 3, 2016).

24 *Id.*

25 See Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

26 *Id.* Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.

27 For example, in a recent article the Chief Information Officer (CIO) of the Social Security Administration (SSA) stated that incremental migration may not be an effective solution to the problem of outdated legacy systems. Instead, he believes that agencies need to understand the business rules and processes that went into the programming of these systems and rewrite the programming from scratch for the modern IT environment. The SSA CIO also believes that these modernization builds can be broken down into several \$25 or \$50 million dollar modules, instead of projects that run hundreds of million dollars or more. See Zach Noble, *It's Time to Trash Your Legacy System and Rewrite From Scratch*, FCW (June 8, 2016), <https://fcw.com/articles/2016/06/08/modernization-acquire-noble.aspx>. In addition, an Australian National Audit Office audit report of the Australian Taxation Office (ATO) describes the ATO's Change Program to develop a cost effective and integrated system of tax administration. As part of this program, the ATO implemented the Client Contact – Work Management – Case Management System (CWC), an enterprise-level system used to manage cases and work items as well as manage telephone calls and correspondence. The audit report notes "The implementation of the CWC has changed the way customer service representatives (CSR) and other Tax Office staff interact with clients. Previously staff were required to refer to several computer systems to obtain enough information to verify a caller's identity, resulting in time-consuming processes for even basic client interactions. Staff only had access to specific items of information on the taxpayer. This meant that advice and information given to the taxpayer was general and could not be tailored to the individual taxpayer's circumstances." See Australian National Audit Office, Audit Report No.6 2010-11, *The Tax Office's Implementation of the Client Contact – Work Management – Case Management System* 17 (Sept. 2010).

28 For an overview of the IRS's "Future State" plans, see IRS, *Future State Initiative* (Feb. 22, 2016), <https://www.irs.gov/uac/newsroom/future-state-initiative>.

## The IRS's Current ECM Strategy Appears to Be Inefficient and Does Not Reflect Lessons Learned From Past Mistakes

### *The IRS's Current ECM Efforts Do Not Appear to Be Successful*

The current ECM effort began in September 2014 with a presentation to IRS senior leadership and, in January 2015, the IRS Commissioner approved a plan for an ECM system that can be used IRS-wide.<sup>29</sup> The IRS's top priority in ECM is ECM fraud case management (EFCM), specifically the retirement and replacement of the Electronic Fraud Detection System (EFDS) program.<sup>30</sup> The IRS has stated that EFCM “will set the technology foundation for Enterprise Case Management.”<sup>31</sup> However, this transition has been fraught with issues and it appears that the IRS will need multiple case management systems, including a new system outside of ECM, to replace EFDS.<sup>32</sup> Thus, instead of creating a “technology foundation” for ECM, it appears that the IRS is creating patchwork and new case systems that will need to be integrated into ECM at a later date.

Because the IRS would not respond to TAS's ECM-related questions, TAS does not have information about how much the IRS has spent on ECM efforts so far, other than the fact that more than \$566 million of the IRS's 2016 Fiscal Year (FY) \$2.5 billion IT budget was available for business systems modernization funding.<sup>33</sup> Additionally, it appears that the IRS has more than \$35 million in ECM commitments, obligations, expenditures, and disbursements (COED) for FY 2016 alone.<sup>34</sup>

### *In Developing Its ECM Solution the IRS Should Learn From Its Previous Unsuccessful Case Management Projects*

It is also important that in developing its ECM solution the IRS look to its own unsuccessful case management efforts to avoid repeating the same mistakes. As noted in a Treasury Inspector General for Tax Administration (TIGTA) report from September 2014, the IRS spent \$8.6 million from FYs 2009 through 2013 developing a failed information reporting and document matching case management (IRDMCM) system.<sup>35</sup> The report indicates that the IRDMCM system requirements were not sufficient, user testing of the system generated a high number of problem tickets, and the system “could not effectively process business cases containing underreported income and could not be deployed into the IRS production environment.”<sup>36</sup> The report also pointed out that the IRS potentially relinquished \$54.9 million in taxes in 2011 alone from unprocessed cases due to the IRDMCM failure.<sup>37</sup> A

29 IRS, *Enterprise Case Management Day, Journey to the Future State* 10 (Aug. 3, 2016). See also TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* 22 (Sept. 2016).

30 IRS, *Enterprise Case Management Day, Journey to the Future State* 45 (Aug. 3, 2016). For a detailed discussion of the high false positive rates within IRS fraud detection programs, see Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*.

31 IRS, *Enterprise Case Management Day, Journey to the Future State* 45 (Aug. 3, 2016).

32 IRS, *Enterprise Case Management Point of Contact Briefing* 4, 11 (Oct. 3, 2016).

33 TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* 4 (Sept. 2016).

34 IRS, *Enterprise Case Management Governance Board* 14 (Oct. 27, 2016).

35 TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* (Sept. 2014). As stated in this TIGTA report, the purpose of the IRDMCM case management system was “to assimilate and correlate data submitted on filed business tax returns to information returns and select individual sole proprietor and business returns for examination.”

36 *Id.*

37 *Id.*

subsequent United States GAO report, from February 2015, put the IRDMCM project cost at \$16.2 million, nearly double the figure mentioned in the TIGTA report.<sup>38</sup>

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In addition, a recent TIGTA report has pointed out issues with three other IRS case management system projects.<sup>39</sup> First, after approximately a year and a half of work and an unspecified amount of money spent on an Affordable Care Act (ACA) case management system, the IRS decided in June 2016 to stop the project in order to free up resources.<sup>40</sup> In addition, the report notes that the IRS developed and spent \$15 million on a Foreign Account Tax Compliance Act (FATCA) database that although built to requirements, “has not provided the intended business results.”<sup>41</sup> However, the semi-automated tool the IRS developed to screen returns for potential irregularities harms thousands of taxpayers, including many international students.<sup>42</sup> Finally, the report describes the IRS’s development of the Return Review Program (RRP), one of the systems that will replace the EFDS. Even though the IRS has been developing RRP since 2009, it does not have an estimated date for its full implementation.<sup>43</sup>

It is also vitally important that the IRS ensure that Entellitrak, the case management platform that it will use for ECM, has the requisite functionality to handle the task of large-scale ECM and the integration of between 60 and 200 separate case management systems. In audit reports of prior IRS individual case management projects, TIGTA recommended that the IRS verify and assess whether Entellitrak’s case management capabilities could meet those project needs.<sup>44</sup> The IRS has a significant investment in Entellitrak, as it entered into a \$50 million contract for its use in 2015, and needs to ensure that it is spending money on an ECM system that will meet its business needs.<sup>45</sup>

### **The IRS Is Overlooking the Largely Completed TASIS Project As a Quick Deliverable and Building Block for the Larger ECM Project**

#### *The IRS Should Take Lessons From the Development of TASIS*

The IRS does not need to look far for assistance with its ECM efforts, as TAS has performed a significant amount of the necessary legwork in developing its TASIS case management system. TAS worked for several years with the IRS’s IT function and a contractor to develop the requirements for TASIS, an

38 GAO, GAO-15-297, *Information Technology: Management Needs to Address Reporting of IRS Investments’ Cost, Schedule, and Scope Information* (Feb. 2015).

39 TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* (Sept. 2016).

40 *Id.* at 22.

41 *Id.* at 24.

42 See Most Serious Problem: *Foreign Account Tax Compliance Act (FATCA): The IRS’s Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *infra*.

43 TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* 25 (Sept. 2016).

44 TIGTA, Ref. No. 2014-20-071, *Information Technology: Improvements Are Needed to Successfully Plan and Deliver the New Taxpayer Advocate Service Integrated System* 11 (Sept. 2014); TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* 15 (Sept. 2014).

45 See U.S. Internal Revenue Service Signs \$50 Million Deal with MicroPact, PR Newswire (Mar. 11, 2015), <http://www.prnewswire.com/news-releases/us-internal-revenue-service-signs-50-million-deal-with-micropact-300048249.html>.

integrated replacement system for its current antiquated TAMIS system. The IRS should pay heed to the process that TAS undertook in developing TESIS. Beginning in 2011, TAS started TESIS development by focusing on processes first (intake strategy, guidance, Operations Assistance Requests (OARs), case-weighting and assignments rules) and only then did the analysis of what the case management program needed to do.

By holding workgroup meetings dedicated to employee technology needs, TAS asked *all* of its employees what they needed to perform their jobs efficiently, recorded their proposals and “wish lists” for capabilities, and tracked them in the development of the business requirements. In other words, TAS built TESIS from the ground up. In addition, unlike the IRS, TAS did not pay a single consultant for the work it did until it started actually writing the computer-based business rules. The initial thinking and planning was done directly by TAS, saving taxpayers significant dollars.

### *TESIS Is a Versatile Case Management System That Can Benefit the IRS As a Whole*

As the National Taxpayer Advocate has discussed in previous Objectives Reports to Congress and congressional testimony, TESIS is a versatile case management system that would replace TAMIS, TAS’s current antiquated system.<sup>46</sup> While ECM focuses on case selection and work assignment capabilities, among other things, TESIS focuses on case intake and case-building functions, creating virtual case files with data auto-populated from other IRS systems and information transmitted electronically between functions for review and action, resulting in a complete picture of the taxpayer’s case and both the IRS and TAS’s actions with respect to that matter. Once TESIS is completed, the IRS can incorporate elements or modules of TESIS into core ECM for use by other IRS business units, including the Exempt Organization function, Appeals, Whistleblower Office, Office of Professional Responsibility, and the Innocent Spouse, Identity Theft, and Offer in Compromise units.

When TAS learned that TAMIS was slated for retirement, it capitalized on the opportunity to integrate all of its systems and business processes into a single state-of-the-art application. TAS developed over 4,500 business requirements<sup>47</sup> for the case management system aspect of TESIS functionality, including:

- Fully virtual case files;
- Electronic access to other IRS case-management systems and automatic retrieval of taxpayer information;
- Electronic submission and tracking of Operations Assistance Requests (OARs);<sup>48</sup>
- Electronic transmission and tracking of Taxpayer Assistance Orders (TAOs);
- Full access to all virtual case information for purposes of management and quality review;
- TAS and taxpayer (and representative) ability to communicate digitally;
- Taxpayer (and representative) ability to electronically check the status of a case in TAS; and
- An electronic case assignment system.

These are just some of the capabilities contained within the TESIS Business System Requirements Report, which collectively illustrates that TESIS’s case management component will not just replace TAMIS but

46 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 195; National Taxpayer Advocate FY 2016 Objectives Report to Congress 98.

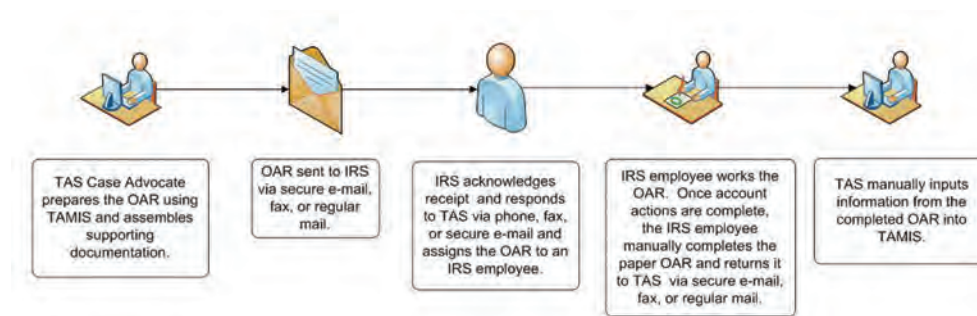
47 TAS, *TESIS Business System Requirements Report* (Nov. 14, 2011).

48 IRS Form 12412, *Operations Assistance Request*, is the form TAS uses when it lacks the statutory or delegated authority to perform an action on a case and must request the IRS to perform that action.

will significantly increase the productivity of TAS case advocates because they will no longer spend their valuable time tracking down paper documents or inputting information into multiple systems. Moreover, taxpayers will be able to communicate efficiently with TAS and electronically send key case information and documents. This functionality will enable TAS's case advocates to spend their time advocating for taxpayers, rather than performing administrative tasks such as manually inputting and tracking documents and IRS actions, thereby upholding taxpayers' *right to quality service*. In short, TESIS reflects the complexity and interaction of cases in the IRS.

The following figure illustrates the current, labor-intensive OAR process, which is representative of many of the challenges of the current manual processes facing both TAS and the larger IRS.

**FIGURE 1.6.1, Operations Assistance Request (OAR) Process**



Without an electronic OAR process:

- Getting an OAR to the right IRS unit may be complicated. There are over 100 options for TAS to choose from, and an incorrect selection can lead to rework, delaying resolution of the taxpayer's problem;
- Very limited data is available for analyzing OAR process performance, such as tracking the reasonable performance expectations in the Service Level Agreements between TAS and IRS operating divisions (ODs);
- Both TAS and the responding OD manually track OAR progress. TAS cannot look up the status, but must call, fax, or email a status request and wait for a response; and
- Supporting documents are not stored electronically, and must sometimes be shared by mail, with related packaging and shipping costs, including expedited handling when the taxpayer's need is urgent.

Implementation of a solution to electronically submit and track OARs, whether in TESIS or ECM, would benefit both TAS and the IRS by reducing delays in case resolution and providing resource savings by eliminating much of the current costs, including shipping, time spent by employees manually inputting and tracking OARs; and physically printing and scanning OARs into other IRS tracking systems. TAS has proposed a separate electronic OAR process since 2015, and to date this request has been denied despite the clear benefits to taxpayers, the IRS, and TAS.<sup>49</sup>

49 See IRS, *Enterprise Case Management (ECM) Governance Board Meeting Minutes* 5 (Aug. 5, 2016); see also IRS response to TAS research request (Nov. 3, 2016).



### *The IRS's Commitment to Completion of TASIS Is Critical for TAS*

At the time the project was halted after the IRS spent \$20 million on it, it was estimated that six months and \$12 million would be needed to complete Release 1 programming, testing, and launch.<sup>50</sup> Despite the demonstrated savings of TASIS and its benefits for all of the IRS, no funding is presently allocated for TASIS. Moreover, the IRS has stated that TASIS has not been identified as a legacy system for the ECM program because it was not placed into production and has therefore not been prioritized for ECM.<sup>51</sup> Yet since 2013, Congress has identified TASIS as a major IT system and requires the IRS to provide quarterly reports on it.<sup>52</sup> The IRS's position appears to contradict a statement made by the IRS nearly two years ago in a required quarterly report to Congress on TASIS. In that report, the IRS stated that if it does not receive ECM funding, it will impact TASIS, which is part of the ECM initiative and uses the same Entellitrak platform.<sup>53</sup> It is also disturbing that despite apparent benefits for both the IRS and TAS, as well as the taxpayers we serve, electronic OARs are not being prioritized as an ECM early delivery.<sup>54</sup>

TAS is ready to begin final TASIS programming as soon as funds are available. If TASIS is not funded to completion, the \$20 million the IRS has spent on it will be wasted and TAS will be forced to invest time and funds in upgrading TAMIS, an obsolete legacy system. This would be an extreme waste of limited resources, and fails to provide TAS's case advocates with the tools they need to effectively and promptly assist taxpayers who are *experiencing significant hardship* in resolving their problems with the IRS. It would also infringe upon taxpayers' *right to a fair and just tax system*.

## CONCLUSION

The IRS's current ECM project has been in existence for nearly two years, has not produced a single ECM product, and appears to lack the planning and focus necessary to succeed. It is critical that ECM not follow the path of prior IRS case management projects, which have resulted in abandoned, wasteful, and incomplete initiatives that have cost taxpayers tens of millions of dollars. Without engaging with its employees and other stakeholders in ECM development, learning from past case management mistakes, and using the TASIS development process and system as a building block for ECM, the end case management product will inevitably be mediocre, have usability issues, and the IRS will likely not realize genuine productivity increases. The National Taxpayer Advocate is concerned that IRS will develop an ECM solution with the lowest common denominator and will not push technology to meet taxpayer needs. This will also have an adverse effect on the IRS's ability to carry out its "Future State" vision. Therefore, both congressional funding and oversight of ECM are needed.

50 Internal Revenue Service FY 2017 Budget Request: Hearing Before S. Subcomm. on Financial Services and S. General Government Comm. on Appropriations, 114th Cong. 27 (2016) (statement of Nina E. Olson, National Taxpayer Advocate). In a required quarterly report to Congress, the IRS stated "Once funding is secured, vendor contracts are in place, and the project resumes, TASIS is expected to deploy in approximately 14 months." IRS Report of Chief Technology Officer, FY 2015 1st Quarter IT Investment Report DRAFT V. 4.1 (Jan. 2015), provided in IRS response to TAS research request (Nov. 3, 2016).

51 IRS response to TAS research request (Nov. 3, 2016).

52 The Senate Appropriations Subcommittee on Financial Services and General Government has repeatedly included TASIS on a list of six "major information technology project activities" about which it has directed the IRS to submit quarterly reports. See S. REP. NO. 114-280, at 40 (2016); S. REP. NO. 114-97, at 39 (2015); S. REP. NO. 113-80, at 34 (2013). In 2014, a similar provision was included in the Senate Appropriations Committee's draft report, but the draft report was not adopted for that year.

53 IRS Report of Chief Technology Officer, FY 2015 1st Quarter IT Investment Report DRAFT V. 4.1 (Jan. 2015), provided in IRS response to TAS research request (Nov. 3, 2016).

54 IRS response to TAS research request (Nov. 3, 2016).



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop its ECM solution from the ground up by actively and comprehensively engaging all its employees and seeking their specific suggestions as to how to make processes and procedures more efficient and maximize employee productivity in order to provide quality customer service to taxpayers.
2. Use TESIS and its foundational work as part of the ECM effort, for example by using TESIS modules that are adaptable for ECM.
3. Provide the funding necessary to complete TESIS Release 1.
4. Prioritize and fund the development of an electronic OAR process.

**MSP  
#7****ONLINE ACCOUNTS: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Operating Division

Paul Mamo, Director, Office of Online Services

Benjamin Herndon, Director, Research, Applied Analytics & Statistics

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

A main component of the IRS's Future State vision is the development of an online taxpayer account.<sup>2</sup> The National Taxpayer Advocate has proposed for years that the IRS develop an online account system for taxpayers.<sup>3</sup> An online account system will benefit those taxpayers who are able to access the digital system and who have the background, knowledge, and experience to navigate through various complex transactions. In order for taxpayers and the government to realize the benefits of an online taxpayer account application, the IRS must address the following:

- Develop an overarching online strategy that focuses on taxpayer service needs and preferences rather than merely business or budget demands;
- Incorporate existing third-party and TAS research on service needs and preferences into its Future State vision;
- “Do Digital Right” by ensuring the online account provides taxpayers with a service they need in the format they need; otherwise taxpayers may lose interest and not return to the site;

<sup>1</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

<sup>2</sup> For more details on the IRS Future State Initiative, see <http://irweb.irs.gov/future/default.aspx> (last visited Nov. 30, 2016).

<sup>3</sup> See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

- Acknowledge the real consequences of strong and necessary e-authentication standards. With about one-third of users passing the multi-factor e-authentication security measures, getting taxpayers through the “front gate” is half the battle;<sup>4</sup> and
- Prioritize practitioner access, authority, and preferences for the online account.

## ANALYSIS OF PROBLEM

### Background

A key initiative to attain the IRS’s envisioned Future State is the development of a taxpayer online account. According to the IRS, the online account will enable taxpayers and eventually authorized third-parties to “securely obtain taxpayer information, make payments, resolve compliance issues, share documentation, and self-correct issues in an individualized, online account.”<sup>5</sup>

The IRS has shared with TAS its bare bones plans to roll out the application. The IRS conducted a soft launch of the first phase of the online account on November 16, 2016, and announced the launch to the public on December 1, 2016.<sup>6</sup> Individual taxpayers currently access the online account through the payments tab of the IRS official website. Once individual taxpayers pass the multi-factor e-authentication standards, as discussed in more detail below, they can view the account balance and select payment options such as IRS Direct Pay, debit or credit card, or apply for an installment agreement.<sup>7</sup>

Despite efforts by TAS, the first phase of the online account does not provide taxpayers with any information on how to dispute the account balance provided.<sup>8</sup> The National Taxpayer Advocate has suggested that the IRS provide a button indicating “I don’t think I owe this amount.” Once the taxpayer clicks on that button, the site should provide links for different options, including: amending a return, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability for offer in compromise. To date, the IRS has not agreed with this recommendation.

By mid-2017, the IRS tentatively plans for the application to enable taxpayers to see up to 18 months of payment history and a transcript summary screen. The National Taxpayer Advocate has encouraged the IRS to increase the 18-month payment history to at least 24 months in order to provide useful information for refund claims.<sup>9</sup> Finally, by the end of 2017, the IRS tentatively plans to add more payment features as well as a fully integrated transcript with search capabilities.<sup>10</sup>

4 National Taxpayer Advocate Notes from Services and Enforcement Executive Steering Committee (S&E ESC) Meeting (Nov. 17, 2016). The pass rate was 28 percent on Nov. 16, 2016, 29 percent on Nov. 17, 2016, and increased to 34 percent as of Dec. 18, 2016. IRS 10-day response to MSP fact check (Dec. 20, 2016).

5 IRS, *Draft IRS Future State: Overview, The Path Traveled and the Road Ahead* 11 (Feb. 2016), [https://www.irs.gov/PUP/newsroom/IRS%20Future%20State%20Journey\\_R.pdf](https://www.irs.gov/PUP/newsroom/IRS%20Future%20State%20Journey_R.pdf) (Oct. 14, 2016).

6 IRS News Release 2016-155, *IRS Launches New Online Tool to Assist Taxpayers with Basic Account Information* (Dec. 1, 2016).

7 IRS S&E ESC, *Online Account Status Briefing* 4, 5 (Nov. 17, 2016); TAS Employee Testing of the Online Account (Nov. 26, 2016).

8 The online account can be accessed from the following IRS payments page: <https://www.irs.gov/payments/finding-out-how-much-you-owe> (last visited Nov. 27, 2016).

9 IRS response to TAS fact check (Dec. 20, 2016). Under IRC § 6511(a), a taxpayer must file a claim for credit or refund of an overpayment within: 1) three years from the time the return was filed, or 2) two years from the time the tax was paid, whichever is later. If no return was ever filed by the taxpayer then the claim must be filed within two years of payment of the tax.

10 Wage and Investment (W&I) response to TAS information request (Sept. 1, 2016); S&E ESC, *Online Account Status Briefing* 5 (Nov. 17, 2016); IRS response to TAS fact check (Dec. 20, 2016).

### Develop an Overarching Online Strategy That Is Driven by Taxpayer Needs and Preferences for Taxpayer Service

The IRS has not developed an overarching online strategy or design for the online account that is based on an understanding of taxpayer skills and abilities, as well as their needs and preferences for the various modes of receiving taxpayer service. To its credit, the IRS conducted the 2014 Taxpayer Choice Model (TCM) study; however, this survey was conducted solely online. Based on the TCM findings, the IRS concluded that it needed “to introduce more online self-service options to help today’s taxpayers meet their tax obligations.” Specifically, the IRS interpreted the results to show that the service channel most used to contact the IRS is the IRS website (28 percent). In addition, the survey indicated that 48 percent of taxpayers chose the online tool as their preferred service channel to obtain the status of a case or transaction. As a result, the IRS developed the “Web Apps Program,” including online account capabilities, “as a direct solution to how today’s taxpayers prefer to interact with the IRS.”<sup>11</sup>

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About one-third of those taxpayers interested in using the online service channel can access the service. While the strict authentication measures are important to safeguard taxpayer data, the initial pass rates show that the online account cannot be the main service channel.

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While the 2014 TCM study demonstrated some interest in online tools by taxpayers who already had internet access, the IRS never conducted more in depth research to determine exactly how taxpayers would prefer to use this tool. While the TCM findings indicate that almost half of already-online taxpayers prefer to get status updates through an online tool, the IRS never conducted a survey to determine if taxpayers would prefer to “self-correct” a return by agreeing to an addition to tax using an online account, or would they prefer to first speak with an assistor about the basis of that adjustment. The focus on online-only surveys, the general vagueness of the survey questions, and the absence of more detailed scenarios and choices means the IRS’s claim that the online account is “a direct solution to how today’s taxpayers prefer to interact with the IRS” is based more on IRS wishing than in reality. The TCM is *some evidence* of how *already-online taxpayers* would like to interact with the IRS about *some activities*. It is not a comprehensive analysis of the online or taxpayer service needs of the U.S. taxpayer population, and to pretend it is undermines the positive aspects of the online account.

Further, the IRS Future State vision focuses primarily on the IRS’s own operating preferences.<sup>12</sup> Accordingly, the IRS is shifting resources away from the more expensive service delivery channels, such as face-to-face and phone service, towards self-service channels that are seemingly less costly. The rationale for this strategy is to free up resources for those taxpayers who still require more personal service.<sup>13</sup> While the IRS’s stated rationale is commendable, it is not supported by sufficient research. A leading best practice supported by research is that organizations in general must understand the needs of the customer

11 IRS Service & Enforcement Executive Steering Committee Briefing: Online Account Status Update 3 (Oct. 17, 2016); Courtney Rasey and Mackenzie Wiley, Wage & Investment Research and Analysis, IRS, *2014 Taxpayer Choice Model (TCM): Designing Digital Communication Products to Reduce Phone and Mail Inventory*, <https://www.irs.gov/pub/irs-soi/15resconwiley.pdf> 172 (last visited Dec. 9, 2016).

12 See Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*. The Swedish Tax Agency, which has received top rank for service among government agencies, has the following guiding principle: “What we think is efficient, may turn out not to be, and what we think is good service is not necessarily so from the taxpayer’s perspective. We have understood the importance of not building our service based on our own internal view of reality.” Vilhelm Andersson, *Mechanisms for Measuring the Quality of Service Provided to the Taxpayer and Results Achieved*, Inter-American Center of Tax Administrations – CIAT, 46th CIAT General Assembly, *Improving the Performance of the Tax Administration: Evasion Control and Taxpayer Assistance*, 169 (2012).

13 National Taxpayer Advocate Public Forum 12 (Feb. 23, 2016).

and let those needs drive the change, rather than business or budget demands.<sup>14</sup> Before the IRS invests too many resources into an online-centric Future State vision, it must conduct extensive research on taxpayer preferences for service delivery channels, based on demographics as well as the type of interaction with the government.<sup>15</sup>

As pointed out by Professor Leslie Book at the February 23, 2016, National Taxpayer Advocate Public Forum on Taxpayer Service Needs and Preferences in Washington, D.C.:

[A] fundamental starting point in thinking about service is that the IRS needs to know whom it is serving and the characteristics and challenges associated with a particular group of taxpayer[s] or parties it is regulating .... An agency fixated on efficiency and delivering services at lowest possible short term costs without knowing the impact and burdens of its actions may find itself pushing more serious problems down the road while at the same time jeopardizing taxpayer rights.<sup>16</sup>

Without extensive research into taxpayer preferences, the IRS may be surprised by the adoption rate of the online account or its impact on call volume. For example, the California Franchise Tax Board did not expect call volumes to increase by 20 percent when it initially launched its online account, MyFTB. Only five percent of taxpayers created an account in the first year and many of the MyFTB users called when they experienced difficulties.<sup>17</sup>

### The IRS Future State Vision Does Not Incorporate Existing Third-Party and TAS Research on Service Needs and Preferences

As noted above, the IRS began developing the online account after the 2014 Taxpayer Choice Model (TCM) study found some interest in online services by taxpayers who already have access to the internet. In addition to the TCM, it conducted the Web-First Strategy Conjoint Study (Conjoint), another online survey. Wage and Investment (W&I) has stated that “the objective of the study was to identify opportunities to increase taxpayer awareness and utilization of web-based customer service delivery options that are convenient, effective, and cost effective for the customer and IRS.” The survey includes information about current and future service options for four service tasks: (1) make a payment, (2) obtain a transcript, (3) obtain tax account information, and (4) authenticate your identity. The IRS interpreted the results of the 2015 Conjoint to indicate a high preference for online services, even for taxpayer assistance center (TAC) users, and predict that triage through appointment-based, walk-in service will facilitate access to online and phone channels.<sup>18</sup> The IRS interpreted the results to show that “[a]ll service needs in this study show a similar pattern with the majority of taxpayers preferring Online

14 See, e.g., Knowledge@Wharton, *Becoming Digital: Strategies for Business and Personal Transformation* (2016); Accenture, Partnership for Public Service, *Government for the People: The Road to Customer-Centered Services* (Feb. 2016).

15 Knowledge@Wharton, *Becoming Digital: Strategies for Business and Personal Transformation* (2016); Accenture, Partnership for Public Service, *Government for the People: The Road to Customer-Centered Services* (Feb. 2016); Organisation for Economic Co-operation and Development (OECD), *Forum on Tax Administration: SME Compliance Sub-Group, Information Note, Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012) (Her Majesty's Revenue and Customs (HMRC) breaks down the taxpayers into segments and retains face-to-face assistance specifically targeted for the “needs help” segment).

16 Oral Statement of Professor Leslie Book, Villanova University Charles Widger School of Law, National Taxpayer Advocate Public Forum 27 (Feb. 23, 2016).

17 Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers' Rights Advocate, National Taxpayer Advocate Public Forum (Aug. 22, 2016); Oral Statement of Susan Maples, California Franchise Tax Board, Taxpayers' Rights Advocate, National Taxpayer Advocate Public Forum 26-27 (Aug. 22, 2016).

18 W&I, *Business Performance Review* 37 (May 10, 2016).

Account in the Future State. In addition, most taxpayers like their Future State better than the options available to them now.”<sup>19</sup>

While we acknowledge that the IRS did attempt to learn taxpayer needs by conducting these studies, we have several serious concerns:

1. **Online Study:** Both the TCM and Conjoint surveys were conducted entirely online and, therefore, left out that portion of the population with no online access. Not only do 33 percent of American adults not have broadband access, and therefore are unlikely to participate in online surveys, but Pew Research has also found that online surveys are biased against the African American and Hispanic American populations.<sup>20</sup> Rather than acknowledge the limitations of the online surveys, the IRS applied these narrow research findings to all taxpayers.
2. **Design of Survey Questions.** For both studies, respondents were presented a finite set of service channel options with predetermined values for attributes such as “time to access service.” An example question from the 2014 TCM is set forth in Figure 1.7.1 below:<sup>21</sup>

**FIGURE 1.7.1, Sample Question from 2014 Taxpayer Choice Model Survey**

“If you wanted to obtain an answer to your tax question, and these were your only options, which would you choose?”

|                                 | Option 1            | Option 2                         | Option 3            | Option 4                |
|---------------------------------|---------------------|----------------------------------|---------------------|-------------------------|
| Service Channel                 | Toll-Free, CSR      | Website, Online Interactive Tool | Smartphone          | Toll-Free, Automated    |
| Time Required                   | 20 minutes          | 10 minutes                       | 5 minutes           | 10 minutes              |
| Progress Toward Resolution      | Completely Resolved | Get Specific Information         | Completely Resolved | Get General Information |
| Social Security Number Required | No                  | No                               | No                  | No                      |
| Personal Info Required          | Yes                 | Yes                              | Yes                 | No                      |
| Tax Info Required               | No                  | No                               | No                  | No                      |

The Conjoint survey questions were similar in format. Both surveys allowed the respondent to choose only one option. If given several options, it is rational for the respondent to choose the service with the lower access times. Most importantly, the survey question shows that the IRS has pre-determined the

19 For a detailed discussion of the research conducted by the IRS to support its shift to online services, see Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*; IRS Wage & Investment (W&I) Research, *Facilitating Access to Convenient & Efficient IRS Service: W&I Web-First Conjoint Study 11, 13* (Sept. 30, 2016).

20 John B. Horrigan and Maeve Duggan, Pew Research Center, *Home Broadband 2015 2-9* (Dec. 21, 2015); Pew Research Center, *Evaluating Online Nonprobability Surveys: Vendor choice matters; widespread Errors Found for Estimates Based on Blacks and Hispanics* (May 2, 2016).

21 W&I Research & Analysis, *Taxpayer Choice Model: Presentation for Excellence through Productivity Improvements and Quality (EPIQ) 8* (Dec. 2014). The IRS has described the Conjoint survey format as follows: “In a conjoint survey, respondents are given service channel options for completing a task and asked to choose which option he/she prefers. This occurs ten times for each service task with the service channel features changing each time. From this data, researchers perform analysis to determine the impact of each service feature to build a predictive model that allows researchers to predict taxpayer preference with perfect awareness within the confines of the service channels and service channel features included in the study.” IRS response to TAS fact check (Dec. 20, 2016).



service options that the taxpayer may express an opinion about (“these were your only options”), rather than providing a broad range of options, including “other”, from which the taxpayer can choose.

Moreover, the question above is actually very misleading. It seems to imply that a taxpayer will spend 20 minutes to achieve complete resolution by calling the toll-free line and talking to a live assistor, but that same taxpayer could achieve complete resolution in five minutes by using a smartphone. However, the question does not make clear what happens in those five minutes with the smartphone — will the taxpayer only get automated prompts (which indicates the taxpayer will receive only general information, as with the automated phone service); or will the taxpayer get through to a live assistor, only faster than the toll-free line? If the latter, it is unclear why a smartphone user should receive faster access to an assistor than a taxpayer who calls on the toll-free line. At any rate, the question is completely muddled and not much use as a basis for strategic decisions, much less service design.

*TAS Performed Research, Held a Dozen Public Forums Across the Country, and Conducted Practitioner Focus Groups, All of Which Produced a Wealth of Information for the IRS As It Develops Its Future Vision*

TAS has conducted research, nationwide Public Forums, and focus groups which produced a wealth of information that is valuable in developing a Future State vision that meets the needs and preferences of taxpayers and practitioners. Specifically, TAS has conducted the following:

1. **Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups.** A nationwide survey of U.S. taxpayers about their needs, preferences, and experiences with IRS taxpayer service conducted entirely by telephone (landline and cell phone). Most importantly, taxpayers were able to choose from a detailed list of reasons why they interacted with the IRS during the past 12 months, including an open-ended “other option.” For their particular service need (*e.g.*, obtain a transcript, tax law question, assistance with an IRS notice, and make a payment), taxpayers were asked to identify the first choice in service channel (*i.e.*, IRS website, TAC, and phone) as well as any additional information sources used. This will enable us to track preferred service channel by service need or task. In addition, participants were asked about their internet access and use. TAS is still in the process of evaluating the results of the survey. Preliminary results show that elderly and low income taxpayers are less likely to have online access, and those who do have online access use it in a very limited manner. The preliminary results also indicate that a large percentage of all taxpayer groups — low income (43.5 percent), not low income (37.2 percent), elderly (60.7 percent), and disabled (44.0 percent) — do not feel secure sharing personal information with a government agency or sharing personal financial information over the internet (56.9 percent, 43.8 percent, 66.2 percent, and 65.1 percent, respectively).<sup>22</sup>
2. **National Taxpayer Advocate Public Forums on Taxpayer Service Needs and Preferences.** During 2016, the National Taxpayer Advocate held 12 Public Forums around the country, most in conjunction with Members of Congress who serve on committees actively engaged in IRS oversight. Each Public Forum heard from a panel of witnesses representative of the community visited. Most panels included a representative from a Volunteer Income Tax Assistance (VITA) site and a Low Income Taxpayer Clinic (LITC); an attorney, Certified Public Accountant, or Enrolled Agent active in representing individuals and small businesses; and witnesses who focused on

22 See Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*; Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

challenges faced by particular taxpayer groups, including English as a Second Language (ESL) and immigrant taxpayers, elderly taxpayers, farmers, U.S. taxpayers living abroad, disabled taxpayers, victims of identity theft, and small businesses hurt by payroll service provider fraud.<sup>23</sup>

- 3. TAS Focus Groups During IRS Nationwide Tax Forums.** During the IRS Nationwide Tax Forums, TAS conducted focus groups, one of which specifically addressed the IRS Future State Initiative. The 58 participants were asked for their thoughts on the online account, including features that they believe are most and least useful, practitioner access and authorizations, and restricting access to Circular 230 practitioners.<sup>24</sup>

Throughout this discussion, we will cite recommendations generated from participants of the above-discussed Public Forms and focus groups.

### *A Plethora of Third-Party Research Is Available to Guide the IRS in Its Strategy*

Existing third party research indicates that a significant percentage of the taxpayer population will not use taxpayer accounts in the way envisioned by the Future State initiative. The National Taxpayer Advocate's 2015 Annual Report cites various studies showing the digital divide in this country and the preference for multiple service delivery channels.<sup>25</sup> Multi-channel service options are considered a best practice in tax administration. A 2015 McKinsey Center for Government report stated that “best-in-class tax administrations are taking a different approach to digitization. Going digital is no longer about making digital channel usage mandatory for 100 percent of citizens — it is about improving the taxpayer experience one segment or service at a time.”<sup>26</sup> In addition, there is a clear trend in private industry and tax administration worldwide to provide multi-channel service options.<sup>27</sup> Finally, as a panelist representing the Electronic Tax Administration Advisory Committee (ETAAC) stated at the February 23, 2016, National Taxpayer Advocate Public Forum: “[W]hether it is online, phone, chat, taxpayer assistance center, VITA site, or through a tax professional, the IRS should provide all of these options to meet the variety of taxpayer preferences.”<sup>28</sup>

In a 2015 nationwide survey of American adults, Pew Research Center found that home broadband adoption has plateaued. Approximately 67 percent of adults had broadband at home in 2015, as compared to approximately 70 percent in 2013. That means 33 percent of U.S. adults did not have home broadband access. This leveling-off of broadband use coincides with an increase in “smartphone-only” adults. Smartphone adoption has reached a similar rate as that of broadband. Specifically, 68 percent of American adults own a smartphone and 13 percent are “smartphone-only.” The most significant rates of

23 For details on the National Taxpayer Advocate Public Forums on Taxpayer Service Needs and Preferences, including submitted written statements from panelists as well as full transcripts of the forums, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Nov. 30, 2016).

24 TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State* 6, 11 (Oct. 2016).

25 National Taxpayer Advocate 2015 Annual Report to Congress 56-63 (Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).

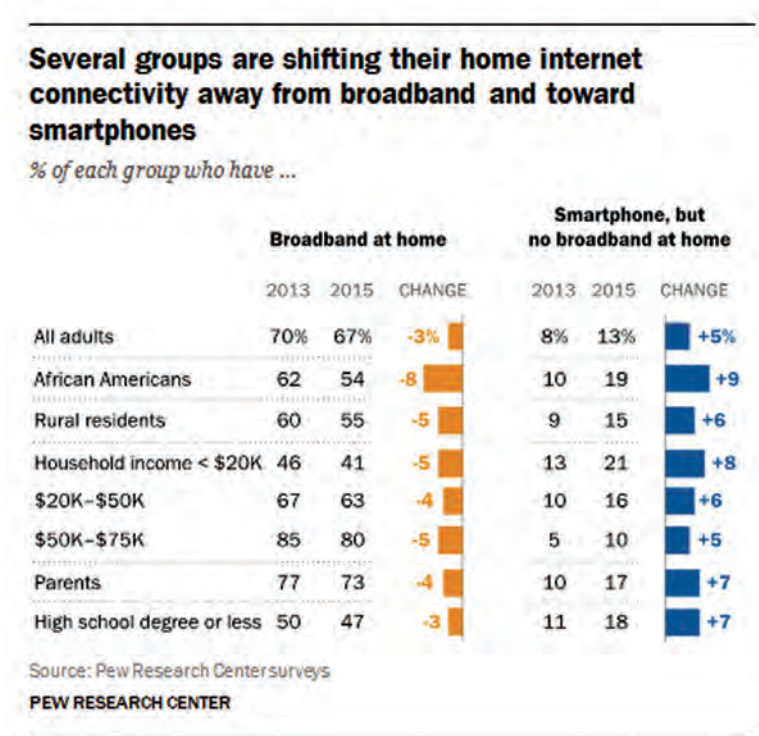
26 Aurélie Barnay, Thomas Dohrmann, Wopke Hoekstra, Jose Nogueira, Fiyinfolu Oladiran, Kristine Romano, McKinsey Center for Government, *Tax Myths-Dispelling Myths About Tax Transformation in Rapidly Growing Economies* 5 (Sept. 2015).

27 Knowledge@Wharton, *Becoming Digital: Strategies for Business and Personal Transformation* (2016); OECD, *Forum on Tax Administration: SME Compliance Sub-Group, Information Note, Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012); Deloitte, *Navigating the New Digital Divide: Capitalizing on Digital Influence in Retail* (2015).

28 Oral statement of Jim Buttanow, National Taxpayer Advocate Public Forum 83 (Feb. 23, 2016).

increase in the smartphone-only populations can be found among African Americans, individuals whose household income is at or below \$75,000, adults living in rural areas, parents, and those with a high school degree or less.<sup>29</sup>

**FIGURE 1.7.2, Pew Research Center Survey Results Showing Shift From Broadband to Smartphones Between 2013 and 2015<sup>30</sup>**



The approximately 33 percent of adults without home broadband access are at a major disadvantage when it comes to various complex tasks, such as accessing government services, getting health information, and applying for jobs.<sup>31</sup> Many without broadband access have to reroute their lives in order to get to a library, school, or coffee shop to access the internet. This presents cybersecurity challenges to those who have to access confidential information from public computers or networks in public locations, potentially carrying documents with confidential information. At a National Taxpayer Advocate Public Forum, a panelist from Pew Research Center noted that 27 percent of Americans have used a computer or Wi-Fi at a public library in the last year.<sup>32</sup> Accordingly, taxpayers attempting to access the online account application in such public locations are not only inconvenienced, but are at greater risk for identity theft.

29 John B. Horrigan and Maeve Duggan, Pew Research Center, *Home Broadband 2015* 2-9 (Dec. 21, 2015).

30 *Id.* at 6.

31 *Id.* Oral Statement of Aaron Smith, Pew Research Center; National Taxpayer Advocate Public Forum 143 (Feb. 23, 2016).

32 Oral Statement of Aaron W. Smith, Pew Research Center, National Taxpayer Advocate Public Forum 176 (Feb. 23, 2016).

*The IRS Strives to Provide Service Offerings Comparable to the Financial Industry, But Ignores Those Offerings When They Do Not Comport with the Direction the IRS Wants to Follow*

In justifying the Future State vision towards online accounts, the Commissioner of Internal Revenue has stated that taxpayers “should expect the same level of service when dealing with the IRS in the future as they have now from their financial institution, whether it’s a bank, brokerage, or mortgage company.”<sup>33</sup> However, the IRS’s approach to Future State is not consistent with the research performed specifically for the financial sector. Research commissioned by the Federal Reserve found that even tech-savvy mobile phone users prefer multiple service channels. Over the past several years, the Federal Reserve has surveyed banking preferences among mobile phone users. According to the most recent report, more mobile phone users who have a bank account reported visiting a branch than using any other channel in the last 12 months.<sup>34</sup>

The existing research findings highlight that online services should supplement rather than replace more personal services. At the National Taxpayer Advocate February 23, 2016 Public Forum, a panelist from the Federal Reserve noted that 80 percent of banking consumers surveyed in 2015 use four or five of the service channels available and only two percent used only one or two channels.<sup>35</sup>

**Doing Digital Right: Just Because the IRS Builds It, Doesn’t Mean Taxpayers Will Use It**

Unless the IRS improves its current quality of taxpayer assistance and correspondence, the text and explanations contained within the digital account will be no less confusing than what taxpayers currently receive.

An online account application can be an extremely useful tool for those with the ability to access the application and who can navigate complex transactions with minimal personal assistance. However, without crucial research into taxpayer and practitioner service needs and preferences, there is a significant risk the IRS will build something few people need or use. For example, as raised in the National Taxpayer Advocate Public Forums, the online account must be more than just a digital version of the guidance and correspondence already in existence in paper form. Unless the IRS improves its current quality of taxpayer assistance and correspondence, the text and explanations contained within the digital account will be no less confusing than what taxpayers currently receive. Many taxpayers will still require additional personal assistance and reassurance to understand how the rules and procedures apply to their particular facts and circumstance.<sup>36</sup>

In a 2015 survey conducted by Forrester Research, respondents indicated a slightly higher level of satisfaction with their in-person interactions with various federal government administrations, compared to their digital interactions through mobile

33 Prepared Remarks of Commissioner John A. Koskinen Before the Tax Policy Center (Aug. 1, 2016), <https://www.irs.gov/uac/newsroom/commissioner-koskinen-remarks-to-the-tax-policy-center> (last visited Nov. 26, 2016).

34 Although more respondents report visiting a branch in the past 12 months, other channels may have been used more frequently during that same period. “Among those who had used each of the channels in the past month, the median number of uses in the past month was five for each of the online and mobile channels, three for ATM, and two for each of the branch and telephone channels.” Board of Governors of the Federal Reserve, *Consumer and Mobile Financial Services 2016 14* (March 2016); Board of Governors of the Federal Reserve, *Consumer and Mobile Financial Services 2015 9* (March 2015).

35 Oral Statement of Arturo Gonzales, Board of Governors of the Federal Reserve, National Taxpayer Advocate Public Forum 157 (Feb. 23, 2016); Board of Governors of the Federal Reserve, *Consumer and Mobile Financial Services 2015 9* (March 2015).

36 See, e.g., Oral Statement of Aaron Smith, Pew Research Center, National Taxpayer Advocate Public Forum 156 (Feb. 23, 2016).

applications, federal websites, and email.<sup>37</sup> More importantly, the survey found that only 39 percent of respondents believe that the federal government should focus on offering more digital services, down from 41 percent the previous year.<sup>38</sup> This clearly indicates a downward trend.<sup>39</sup> When asked if they had the choice between trying to find the answer to a government question online or by picking up the phone and calling somebody, approximately 60 percent of respondents to the nationwide Forrester Research survey said they prefer the phone. Based on the research findings, a panelist from Forrester Research at the National Taxpayer Advocate Public Forums provided four general recommendations on how the government can do digital right:

1. Find the right channel for each service;
2. Design mobile services more strategically;
3. Market the digital services by explaining the benefits of digital channels; and
4. Ensure that those customers who do not interact digitally are still able to interact as easily, conveniently, and effectively as possible.<sup>40</sup>

In addition, the panelist from Forrester Research recommended the IRS add wizard tools to the online account to walk users through the various steps in complex rules and procedures in a straightforward and somewhat customized manner.<sup>41</sup>

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**When asked if they had the choice between trying to find the answer to a government question online or by picking up the phone and calling somebody, approximately 60 percent of respondents to the nationwide Forrester Research survey said they prefer the phone.**

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Given the reluctance of individuals to use government digital services, as illustrated by the above-mentioned Forrester study, it is incumbent on the IRS to “do digital right” when launching the online account. The first phase of the IRS online account provides the first installment of a minimum viable product which includes account balances and payment options. These services that will be useful to those lucky taxpayers able to pass the IRS three-factor authentication (discussed below); it also will provide a useful tool to assist taxpayers who receive IRS scam calls, since they could go online to verify the existence of a tax debt.

However, the IRS is not promoting the account as a fraud prevention tool. In addition, taxpayers who are able to access the account are not given the option or information on how to dispute the account balance provided. The National Taxpayer Advocate has urged the IRS to provide a link on the page to give the taxpayer an option, other than paying the tax, to dispute the balance. When the taxpayer clicks on a button indicating “I don’t think I owe this amount,” as illustrated in Figure 1.7.3, the IRS should provide links for different options, including: amending a return, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability offer in compromise. With such limited options that may not even address the taxpayer’s needs, the taxpayer may lose trust in the online account and never return, even for

37 Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience 2* (Feb. 18, 2016). This report is based on Forrester’s North American Consumer Technographics® Healthcare and Government Survey, 2015. Specifically, respondents had a 72 percent satisfaction rate for in person interaction in the past 12 months with such administrations as the U.S. Post Offices, Social Security Administration (SSA) locations, and Veterans Affairs regional benefits offices. The satisfaction rates were 70 percent for federal mobile applications and 69 percent for federal websites or email.

38 Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience 4-5* (Feb. 18, 2016).

39 Oral Statement of Rick Parrish, Forrester Research, National Taxpayer Advocate Public Forum 114-15 (May 17, 2016).

40 *Id.* at 116-21.

41 *Id.* at 163-65.



future releases. As Rick Parrish of Forrester Research stated: “One of the best things the IRS can do is provide a much better experience when people do have to deal with it, and they will be much more likely to come back when they don’t have to.”<sup>42</sup>

**FIGURE 1.7.3, TAS Proposed Prototype of Online Account Payments Page With the Recommended “I Don’t Think I Owe This Amount” Button**

The screenshot displays a web interface for the IRS. At the top, the IRS logo is on the left, and 'Welcome, Taxpayer | Logout' is on the right. The main content area is divided into two columns. The left column features a large white box with the text 'As of Nov 17, 2016, you owe: \$0.00' and a smaller note below it: 'The information provided is based on our current data.' Below this is a table titled 'Overview by Tax Year' with two columns: 'Tax Year' and 'You Owe'. The table lists years from 2015 down to 2012, all showing a balance of \$0.00. The right column is titled 'Payment Options' and contains four buttons: 'PAY BY BANK ACCOUNT', 'PAY BY CARD', 'NEED MORE TIME TO PAY?', and 'I DON'T THINK I OWE THIS AMOUNT'. A yellow arrow points to the last button. At the bottom of the page, there is a footer with the IRS logo, 'Privacy Policy', and 'Accessibility' links.

| Tax Year | You Owe |
|----------|---------|
| 2015     | \$0.00  |
| 2014     | \$0.00  |
| 2013     | \$0.00  |
| 2012     | \$0.00  |

### E-Authentication: Getting Taxpayers Through the “Front Gate” Is Half the Battle

Authentication is perhaps the most important feature of the online account. While we are not experts on what is the required level of security for an online account, TAS does have expertise on the consequences of heightened security, in terms of limits on taxpayer access and usability, and the downstream consequences of those limitations if the IRS focuses resources on digital channels. For the application to be effective, taxpayers need to feel confident that their data is protected.<sup>43</sup> In a recent Forrester Research survey, only 32 percent of respondents agreed with the statement “I am confident that the federal government keeps secure any personal information it has on its citizens.”<sup>44</sup>

To achieve a high level of security, however, e-authentication measures can become a barrier to entry for a significant portion of the taxpayer public. The National Taxpayer Advocate is not suggesting that the IRS relax its digital security protections. The IRS should acknowledge that strict e-authentication blocks

42 Oral Statement of Rick Parrish, Forrester Research, National Taxpayer Advocate Public Forum 159 (May 17, 2016).

43 Treasury Inspector General for Tax Administration (TIGTA), *Improved Tax Return Filing and Tax Account Access Authentication Processes and Procedures Are Needed*, Ref. No. 2016-40-007 (Nov. 19, 2015).

44 Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience* 6 (Feb. 18, 2016).



access, and design its service strategy accordingly so that the blocked taxpayers have other suitable service channels available, including person-to-person assistance.<sup>45</sup>

### *The IRS Adopted Strict E-Authentication Standards for Get Transcript Online, Which Will Limit Access*

A concrete example of how e-authentication can act as a barrier to entry is the 2016 launch of the “Get Transcript Online” application.<sup>46</sup> The e-authentication procedures, called Secure Access, used for Get Transcript Online, were later used for the online account application, which was soft launched on November 16, 2016, and publicly announced on December 1, 2016.<sup>47</sup> Therefore, in order to gain access to both online applications, taxpayers need to pass a multi-factor authentication process by providing the following:<sup>48</sup>

1. **Identity proofing authentication:** Provide a name, email address, birthdate, Social Security number, and filing status and address from the most recent tax return;
2. **Financial verification authentication:** Provide an account number from one of the following:
  - Credit card (not debit card or American Express);
  - Automobile loan;
  - Principal home mortgage;
  - Home equity line of credit; and
3. **Phone verification authentication:** Provide a readily available mobile phone. Only U.S.-based mobile phones may be used. The taxpayer’s name must be associated with the mobile phone account. Landlines, Skype, Google Voice or similar virtual phones as well as phones associated with pay-as-you-go plans cannot be used.<sup>49</sup>

Before the initial testing of the Get Transcript Online application, it should have been clear that a significant portion of the taxpayer population could, by definition, not pass e-authentication to gain access. For example, taxpayers who do not have a credit card and do not own either a home or automobile are by default excluded from the application. Thus, a significant portion of taxpayers renting apartments in big cities where residents rely on mass transit can only gain access if they have a credit card in their own name.

45 Cybersecurity and Protecting Taxpayer Information: Hearing Before the S. Comm. on Finance, 114th Cong. (Apr. 12, 2016) (written statement of John Koskinen, Commissioner, Internal Revenue Service); National Taxpayer Advocate 2015 Annual Report to Congress 56-63 (Most Serious Problem: Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online).

46 IRS, *IRS Launches More Rigorous e-Authentication Process and Get Transcript Online*, IR-2016-85 (June 7, 2016).

47 IRS News Release 2016-155, *IRS Launches New Online Tool to Assist Taxpayers with Basic Account Information* (Dec. 1, 2016); Luca Gattoni-Celli, *Olson Details IRS Online Account Requirements, Remains Skeptical* TAX NOTES TODAY, Tax Analysts (May 18, 2016).

48 IRS, *How to Register for Get Transcript Online Using New Authentication Process*, FS 2016-20 (June 2016); IRS, *Welcome to Get Transcript*, <https://www.irs.gov/individuals/get-transcript-beta> (last visited October 14, 2016); IRS, *Get Transcript Frequently Asked Questions (FAQs)*, <https://www.irs.gov/individuals/get-transcript-faqs> (last visited October 14, 2016). The IRS verifies the financial account and mobile phone information with an external vendor.

49 IRS response to TAS fact check (Dec. 20, 2016). As discussed below, in August 2016, the IRS modified the phone verification requirement to provide that those who do not have a text-enable mobile phone can choose the “PIN in Mail” option. This enables the user to request the IRS to physically mail a Personal Identification Number (PIN) to the taxpayer’s address of record via U.S. mail instead of receiving the PIN via SMS text.

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**A leading best practice supported by research is that organizations in general must understand the needs of the customer and let those needs drive the change, rather than business or budget demands.**

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The phone requirements impact a significant population of taxpayers. From the outset, it was clear that international taxpayers could not gain access to the online application due to the U.S.-based mobile phone requirements of e-authentication. These taxpayers would possibly stand to benefit the most from online access because they already experience difficulty trying to access personal services.<sup>50</sup>

In addition, the phone requirements exclude those taxpayers who do not have a contract mobile phone plan or whose mailing address does not match the billing address. Therefore, anyone on a family mobile phone plan who does not live in the same household as the contract holder would be excluded. As the IRS developed these authentication measures, the Social Security Administration (SSA) struggled with these same issues. SSA recently eliminated a mandatory text-based authentication measure from its my Social Security online account program, due to congressional and other stakeholder concerns raised about the burden it imposes on the elderly and disabled populations.<sup>51</sup>

In August 2016, the IRS attempted to expand coverage for users who are unable to register because they could not satisfy the previous authentication requirement to have a text-enabled mobile phone of record. The IRS implemented the “PIN in Mail” option to enable the user to request the IRS to physically mail a Personal Identification Number (PIN) to the taxpayer’s address of record via U.S. mail instead of receiving the PIN via SMS text to a text-enabled mobile phone.<sup>52</sup> This resolution may prolong the account registration process, but it does provide a viable option to those who could not otherwise satisfy the phone verification authentication step.<sup>53</sup>

***Once the IRS Launched Applications With Necessary Multi-Factor E-Authentication Standards, It Experienced Low Pass Rates***

As anticipated, both the Get Transcript Online and online account applications had low overall pass rates. Once the IRS launched the Get Transcript Online application on June 7, 2016, Secure Access authentication users experienced an overall pass rate ranging from 27 to 29 percent.<sup>54</sup> Likewise, early data after the soft launch of the online account application on November 16, 2016 showed a 28 percent pass rate. The rate increased to 29 percent on November 17, 2016 and steadily increased to 34 percent as of

50 Oral Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 51 (May 17, 2016); (“[T]hat poses a huge obstacle for our community. It virtually blocks them completely out of being able to use online. And you know obviously, ... online and more automated would certainly help our community.”); Written Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 3 (May 17, 2016); National Taxpayer Advocate 2015 Annual Report to Congress 72-81 (Most Serious Problem: *International Taxpayer Service: The IRS’s Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*).

51 Office of the Inspector General, SSA, *SSA Rolls Back Multifactor Authentication on My Social Security* (Aug. 23, 2016).

52 Email on August 2016 Secure Access – Monthly Status (Aug. 19, 2016). The California Franchise Tax Board incorporated a physical mailing of a Personal Identification Number (PIN) to the address of record into its authentication procedures for MyFTB. While this introduces a delay into the process, it is a necessary safeguard. Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers’ Rights Advocate, National Taxpayer Advocate Public Forum (Aug. 22, 2016).

53 Oral Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 24 (May 17, 2016); Written Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 3 (May 17, 2016).

54 Email briefing on Secure Access - Authentication - Weekly Status Report, June 13 -17, 2016 (June 19, 2016); Email on August 2016 Secure Access – Monthly Status (Aug. 19, 2016); IRS response to TAS fact check (Dec. 20, 2016) (“The rate fluctuates and reflects the user-base of various applications as they come online.”).

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**IRS should acknowledge that strict e-authentication blocks access, and design its service strategy accordingly so that the blocked taxpayers have other suitable service channels available, including person-to-person assistance.**

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December 18, 2016.<sup>55</sup> While the strict authentication measures are important to safeguard taxpayer data, the initial pass rates show that the online account cannot be the main service channel. About one-third of those taxpayers interested in using the online service channel can access the service. If the IRS is promoting this application as a main component of its Future State vision, yet approximately two-thirds of taxpayers who want to use the application cannot access it, the IRS is overvaluing the application's reach.

The California Franchise Tax Board (FTB) faced similar issues addressing security and access concerns for its MyFTB online account. The FTB had to incorporate a delay into the account registration and practitioner access procedures to increase security measures. The FTB now sends a PIN to the taxpayer's or practitioner's address of record during account registration to verify the user's identity.<sup>56</sup> It also instituted a delay into the practitioner authorization process to provide time to the taxpayer to acknowledge the client/representative relationship. As a result, practitioners complained that the online account is less useable in their business if they need quick access to the client's tax information such as when there is a short deadline to respond to a notice, meaning practitioners will continue to rely on telephone service channels, if not face-to-face contacts.<sup>57</sup>

### *Cybersecurity Is a Top Priority for Any Online Strategy*

Because cybersecurity is of top concern and any breach can have significant impact on taxpayer's trust in the agency, not to mention use of online services overall, the IRS must stay abreast of the latest updates and best practices used throughout the government and private industry, both domestic and international. In 2015, the Treasury Inspector General for Tax Administration (TIGTA) found that in some of the security breaches that the IRS failed to comply with government information security standards provided by the Office of Management and Budget (OMB) and the National Institute of Standards and Technology (NIST). This failure allowed unscrupulous individuals to gain unauthorized access to tax information in the Get Transcript and IP PIN applications. The IRS agreed to conduct a review of the e-authentication risk assessment process to ensure that all current and future online applications comply with the standards.<sup>58</sup> The IRS created a cross-functional team to consistently apply risk-based authentication measures across all channels of taxpayer service, not just online services. Through our briefings with this team, we have learned that NIST is in the process of updating its standards, in a way that may require updates to the two-step Secure Access authentication IRS launched in June 2016. Specifically, the new standards discourage the use of SMS texts and encourage in-person authentication

55 National Taxpayer Advocate Notes from S&E ESC Meeting (Nov. 17, 2016). The pass rate was 28 percent on Nov. 16, 2016, 29 percent on Nov. 17, 2016 and increased to 34 percent as of Dec. 18, 2016. IRS response to TAS fact check (Dec. 20, 2016).

56 Tax preparers create their own MyFTB account and access their client's information through their own account. The account will automatically populate a client list for all active Power of Attorney declarations on file with the FTB. The FTB will mail the account registration PIN to the preparer's address on the PTIN record. See State of California Franchise Tax Board, *MyFTB for Tax Preparers*, [https://www.ftb.ca.gov/online/myacct/tax\\_preparers.asp?WT.mc\\_id=Professionals\\_Online\\_MyFTBAccount&WT.svl=PPr2](https://www.ftb.ca.gov/online/myacct/tax_preparers.asp?WT.mc_id=Professionals_Online_MyFTBAccount&WT.svl=PPr2) (last visited Dec. 10, 2016); State of California Franchise Tax Board, *Tax Preparer: How to Register for a MyFTB Account*, <https://www.ftb.ca.gov/online/myacct/help/register-tax-preparer.shtml> (last visited Dec. 10, 2016).

57 Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers' Rights Advocate, National Taxpayer Advocate Public Forum 1-2 (Aug. 22, 2016).

58 TIGTA, *Improved Tax Return Filing and Tax Account Access Authentication Processes and Procedures Are Needed*, Ref. No. 2016-40-007, 13-19 (Nov. 19, 2015).

measures for high risk applications.<sup>59</sup> As discussed above, the IRS recently launched multi-factor authentication measures to include SMS texts. Furthermore, the IRS is evaluating many different authentication measures across the agency's service channels and considering a way to leverage in-person authentications that already occur within the IRS as well as other federal agencies and private financial institutions.<sup>60</sup>

### **Practitioners Have Expressed a Real Interest in Using the Online Account But Practitioner Access, Authority, and Preferences Seem to Be an After-Thought**

During the National Taxpayer Advocate Public Forums, as well as focus groups conducted by TAS during the 2016 IRS Tax Forums, practitioners have expressed a real interest in using the online account. This group of users promises to have significant downstream savings for IRS resources. However, the IRS has not shared any detailed plans about practitioner access to the account, the procedures to authorize such access, or planned account features and capabilities geared toward practitioners.<sup>61</sup> If the IRS fails to engage with practitioners during the design phase and fails to provide details on how practitioner access fits into the Future State vision, it will result in an online account that does not work for the taxpayer or practitioner community.

As background, the National Taxpayer Advocate has recommended that the IRS restrict third party access to taxpayer data available on the online account. First, only practitioners who are subject to Circular 230 oversight should be able to access an online account and take actions on behalf of the taxpayer.<sup>62</sup> Second, for both practitioners and any other authorized third-parties, the taxpayer should maintain strict control over which detailed actions the preparer or third party can take on behalf of the taxpayer.<sup>63</sup>

The IRS has indicated that only the taxpayer can create the taxpayer's online account. The National Taxpayer Advocate agrees with this approach. However, the IRS has not provided information as to how the practitioner will access the taxpayer information through the online account. Does the IRS have plans to update Form 2848, *Power of Attorney and Declaration of Representative*, to provide online account access? Will the account have safeguards to limit access as specified by the taxpayer? All of these questions remain unanswered.

The IRS has also not addressed how a practitioner can utilize the online account if the taxpayer has no online access or fails to pass the e-authentication requirements. The California Franchise Tax Board has addressed this issue by providing that taxpayers and preparers each create their own account. The preparer's account will automatically populate with a client list of those taxpayers for which the preparer

59 TAS Briefing by W&I Identity Risk Assurance (July 12, 2016); NIST, Draft NIST Special Publication 800-63B: Digital Authentication Guideline 34 (July 13, 2016).

60 The NIST guidance will not deprecate the use of SMS texts until the issuance of NIST SP 800-63-4. In the interim, the IRS will work to comply with NIST guidance. IRS response to TAS fact check (Dec. 20, 2016); IRS, *IRS Identity Assurance – Authentication Strategy Executive Summary* (June 20, 2016); TAS Briefing by W&I Identity Risk Assurance (July 12, 2016). For example, certified acceptance agents conduct in-person authentication for domestic and international taxpayers in need of an Individual Taxpayer Identification Number (ITIN). In addition, many banks conduct similar authentication for domestic and international taxpayers opening up bank accounts.

61 W&I response to TAS information request (Sept. 1, 2016).

62 The National Taxpayer Advocate supports providing access to certain preparers, but only if they have satisfied robust minimum competency standards, which include a one-time "entrance" examination to ensure basic competency in return preparation and continuing education courses to ensure preparers keep up to date with the many frequent tax-law changes. The current voluntary Annual Filing Season Program does not satisfy this threshold.

63 For a detailed description of these recommendations, see National Taxpayer Advocate 2015 Annual Report to Congress 64-70 (Most Serious Problem: *Preparer Access to Online Accounts: Granting Uncredentialed Preparers Access to an Online Taxpayer Account System Could Create Security Risks and Harm Taxpayers*).

has a power of attorney on file. The preparer will only have authority to access data and act on behalf of the taxpayer as detailed in the power of attorney.<sup>64</sup> This way, a taxpayer does not necessarily need to have an online account to authorize a preparer to take actions through an online account service channel. The IRS could create a similar process with built-in safeguards, such as providing notifications to the taxpayer, either digitally or by mail, as designated by the taxpayer on a revised Form 2848.<sup>65</sup>

In addition to access issues, practitioners at the various Public Forums and focus groups provided useful information about the information they would like to see available on the online account. Many expressed interest in the following types of information and services:<sup>66</sup>

- Images of tax returns;
- Images of notices and correspondence;
- Images of documents in the administrative file;
- Ability to submit documents and with a return receipt acknowledgement;
- Taxpayer's transcript, written in plain language, to clearly set forth the status of filings, payments, correspondences, and compliance activities;
- A means to communicate quickly with the IRS and document such communications and correspondence; and<sup>67</sup>
- Access to information from all IRS systems necessary to resolve a question or issue.

However, what the IRS plans to deliver may be quite different than what practitioners have indicated they need at the National Taxpayer Advocate's Public Forums. Practitioners at the TAS focus groups indicated that a balance due breakdown and payment options are among the least useful capabilities for the online account. Yet, this is exactly what the IRS has provided in its initial release of the application.<sup>68</sup>

64 See State of California Franchise Tax Board, *MyFTB for Tax Preparers*, [https://www.ftb.ca.gov/online/myacct/tax\\_preparers.asp?WT.mc\\_id=Professionals\\_Online\\_MyFTBAccount&WT.svl=PPr2](https://www.ftb.ca.gov/online/myacct/tax_preparers.asp?WT.mc_id=Professionals_Online_MyFTBAccount&WT.svl=PPr2) (last visited Dec. 10, 2016); State of California Franchise Tax Board, *Tax Preparer: How to Register for a MyFTB Account*, <https://www.ftb.ca.gov/online/myacct/help/register-tax-preparer.shtml> (last visited Dec. 10, 2016).

65 Taxpayer Advocate Service Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State 10-11* (Oct. 2016) (Participants unanimously agreed that taxpayers should receive notification of preparer access on the account).

66 See, e.g., Oral Statement of Robert Hamilton, Managing Attorney MidPenn Legal Services LITC, National Taxpayer Advocate Public Forum 10-12 (April 8, 2016). Written Statement of Erik Schryver, Qualified Tax Expert, National Taxpayer Advocate Public Forum (March 18, 2016); Written Statement of Michael L. Such, Research Assistant, Lewis & Clark LITC, Lewis & Clark Law School, National Taxpayer Advocate Public Forum (Aug. 18, 2016); TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State 6, 7, 11* (Oct. 2016). For an example of an online account with comprehensive features, see California Franchise Tax Board, *MyFTB*, <https://www.ftb.ca.gov/online/myacct/> (last visited October 14, 2016); Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers' Rights Advocate, National Taxpayer Advocate Public Forum (Aug. 22, 2016).

67 As an example, the French Tax Administration requires the government to respond to email questions within 48 hours. OECD, *Forum on Tax Administration: SME Compliance Sub-Group, Information Note, Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012).

68 TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State 9* (Oct. 2016).

## CONCLUSION

In order to build an online account system that taxpayers actually use, the IRS must develop an overarching online strategy that incorporates comprehensive research through a variety of media to determine taxpayer and practitioner preferences for different service channels. In designing new research and interpreting existing research, the IRS should recognize that many taxpayers will require multiple channels, including person-to-person assistance, to resolve their issues. TAS has conducted research and held focus groups and Public Forums around the country over the past year, and has received valuable suggestions and comments from a variety of researchers, practitioners, taxpayers, consumer advocates, and government officials. We encourage the IRS, in conjunction with the National Taxpayer Advocate, to review the findings of TAS's *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups* study as well as written statements, transcripts, and reports from the Public Forums and focus groups. Finally, while robust e-authentication measures are crucial, the launch of the Get Transcript Online and online account application has proven that such measures act as a barrier to entry for most potential users. Accordingly, the IRS may be overselling the impact the online account will have in reducing taxpayer usage of other service channels.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. By mid-2017, make available at least 24 months of payment history, rather than only 18 months, on the online account in order to provide information necessary for refund claims.
2. By mid-2017, provide a link on the payments page of the online account to give the taxpayer an option, other than paying the tax, to dispute the balance due shown. The IRS should provide a button on the payment page indicating "I don't think I owe this amount." Once the taxpayer selects this option, the IRS should provide links for different options, including: amending a return, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability offer in compromise.
3. Work collaboratively with the National Taxpayer Advocate to review the recommendations of participants in the 2016 National Taxpayer Advocate Public Forums, the 2016 IRS Nationwide Tax Forum TAS Focus Groups, as well as the findings of TAS and third party research, and address the public's recommendations in the plans for the online account.
4. Conduct research, in consultation with the National Taxpayer Advocate, using a variety of methods (online, landline and cell phone) into taxpayer and practitioner service needs and preferences for the various existing and proposed service channels by type of transaction, with acknowledgement that the taxpayer may choose multiple service channels to resolve a single issue.
5. Incorporate into the Future State vision realistic expectations for access to and use of the online account application given robust e-authentication measures.
6. Limit access to the online account to only those practitioners who are subject to Circular 230 oversight.



MSP  
#8**EARNED INCOME TAX CREDIT (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

The Earned Income Tax Credit (EITC) was enacted as a work incentive in the Tax Reduction Act of 1975.<sup>2</sup> It has become one of the government's largest means-tested anti-poverty programs.<sup>3</sup> In tax year (TY) 2014, 27.5 million taxpayers received about \$66.7 billion in EITC benefits.<sup>4</sup> Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy "application" process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of case workers and local agencies to make eligibility determinations. However, the easy application process of the EITC is also associated with a high improper payment rate, which must be considered in any efforts to improve the EITC.<sup>5</sup>

The IRS recently announced its intention to pursue a "Future State" plan.<sup>6</sup> Major goals of the plan are to improve tax processing systems, increase electronic filing and payment options, and expand services available on [irs.gov](http://irs.gov).<sup>7</sup> The IRS's Future State plans, which emphasize a reliance on technology and

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975).

3 Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

4 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc> (last visited Dec. 31, 2016).

5 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, § 2(e) (2010) amending Improper Payments Information Act of 2002, Pub. L. No. 107-300 (2002) by striking § 2(f) and adding (f)(2). The IRS estimates that the 2015 Earned Income Tax Credit (EITC) improper payment rate is about 24 percent (which accounts for an estimated \$15.6 billion in improper payments). *Projected Improper Payments for Earned Income Tax Credit (EITC)*, <https://paymentaccuracy.gov/tabular-data/projected-by-program/420> (last visited Dec. 31, 2016).

6 IRS, *Future State Initiative*, <https://www.irs.gov/uac/newsroom/future-state-initiative> (last visited Dec. 31, 2016).

7 *Id.*

taxpayer self-help, as opposed to communication with the taxpayer, will do a disservice for many low income taxpayers by compounding existing obstacles facing this population.

The National Taxpayer Advocate has the following concerns with the Future State's reliance on online tools for EITC taxpayers:

- The Future State is not reflective of low income taxpayers' experiences;
- Recent legislative changes make unintentional EITC errors very harmful to taxpayers; and
- The IRS has proceeded with Future State plans without researching or addressing how it will affect low income taxpayers.

## ANALYSIS OF THE PROBLEM

### Background

The EITC is a complex area of law and most low income taxpayers require specialized assistance in order to claim the credit successfully.<sup>8</sup> However, the IRS primarily relies on the correspondence audit process in order to address questionable claims *after* a return has been filed. EITC audits make up approximately 36 percent of all IRS audits despite the fact that EITC returns account for only about 19 percent of all individual income tax returns filed.<sup>9</sup> Thus, the EITC involves a large segment of the individual taxpayer population and comprises a significant portion of the IRS workload.

### *The Future State Is Not Reflective of Low Income Taxpayers' Experiences*

To illustrate its plans for the Future State, the IRS has published “vignettes” of different taxpayers' experiences interacting with the IRS of the future. These vignettes are the most detailed representations to date of the IRS vision of its Future State.” One vignette sets forth an example of what a taxpayer may experience when he or she claims the EITC.<sup>10</sup> The example tells the story of Jane, a taxpayer who has a 19 year-old son and who has recently returned to the workforce. The example illustrates that Jane created an online IRS account and filed her tax return claiming her son. After filing, the IRS sent Jane a digital message saying that she may not qualify for the EITC because it did not have information to show that Jane's son is a full-time student. At this point, Jane talked to her son and determined that, in fact, he was not a full-time student. Jane then logged into her account to resubmit her return, this time without claiming the EITC. The vignette is reproduced in Figures 1.8.1 and 1.8.2.

<sup>8</sup> National Taxpayer 2015 Annual Report to Congress 240-47.

<sup>9</sup> IRS, *2015 Data Book*, table 9a (comparing the number of EITC returns filed and the number of EITC audits in footnote 5 of the same table). There were a total of 146,861,217 individual returns filed, of which 28,308,931 claimed the EITC (this number differs from the data referenced in footnote 4, *supra*, because it reports on EITC returns in calendar year 2014 (primarily tax year 2013) and includes all EITC claims, not just recipients). There were 445,594 EITC audits and 1,228,117 total individual audits. In footnote 4, *supra*, it is reported that 27.5 million taxpayers received the EITC in 2014.

<sup>10</sup> IRS, *Individual Taxpayer Experience of the Future*, <https://www.irs.gov/pub/newsroom/irs-individual-vignette-version-a.pdf>.

FIGURE 1.8.1

# INDIVIDUAL

## Taxpayer Experience of the Future

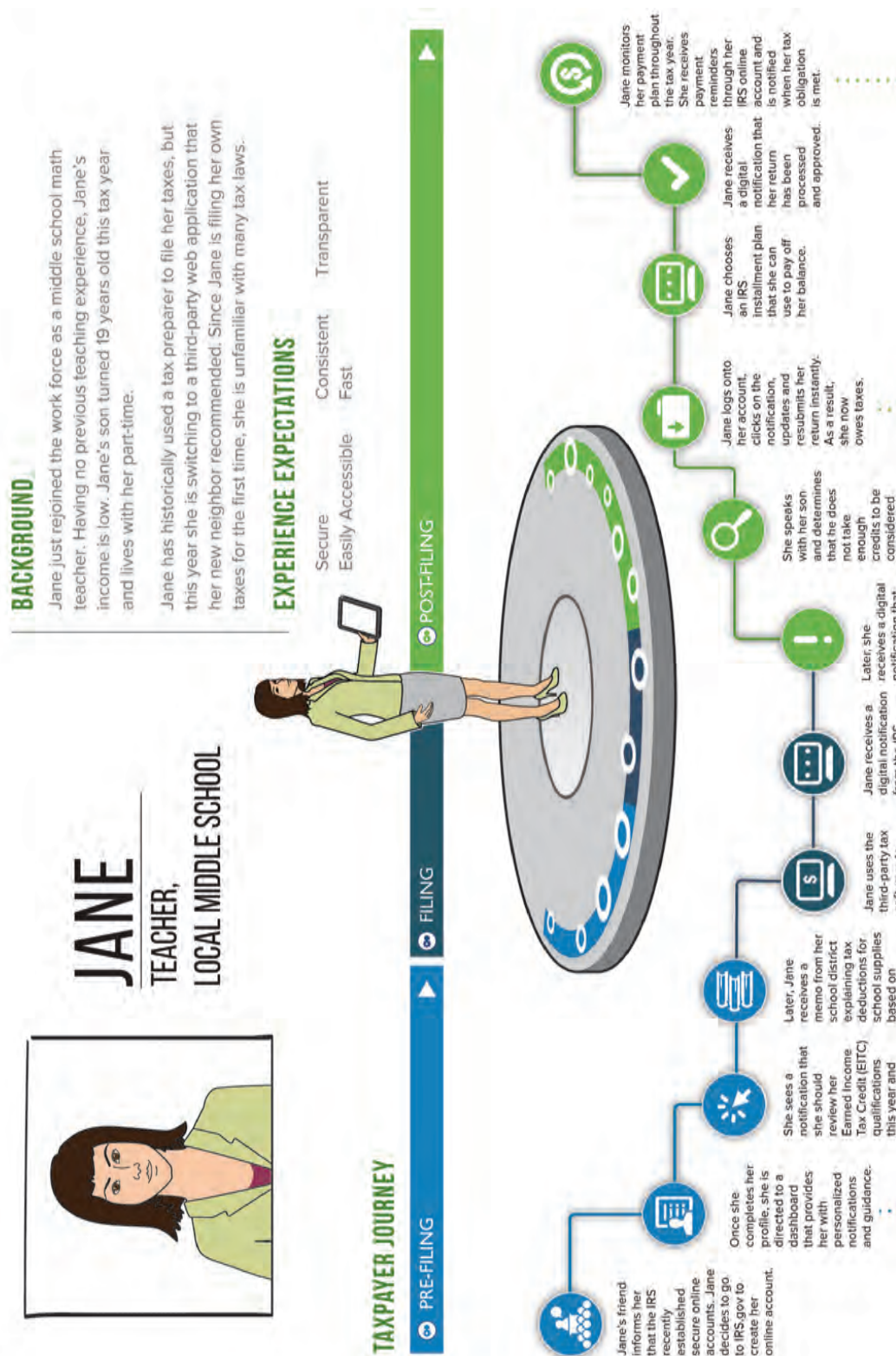




FIGURE 1.8.2



The facts in an Earned Income Tax Credit case are often complex and fluid, since they involve the personal lives of taxpayers. These are not the kind of cases that can be resolved with a one-stop online experience.

The National Taxpayer Advocate does not believe the vignette is illustrative of the normal experience for EITC taxpayers but instead assumes an idealized EITC taxpayer that is far-divorced from reality.<sup>11</sup> As for all taxpayers, the extent to which Jane would be entitled to EITC depends, among other things, on the amount of her adjusted gross income (AGI), whether she filed a joint return, and how many “qualifying children” she has.<sup>12</sup> The vignette describes Jane as a middle school math teacher with no previous teaching experience and with one qualifying child. The vignette notes that “Jane’s income is low.”

Figure 1.8.3 shows the entry-level salaries for middle school math teachers in the 11 cities in which a National Taxpayer Advocate Public Forum was held. The figure also shows the income limitations for claiming EITC in 2014-2016 for taxpayers with one qualifying child who did not file a joint return.<sup>13</sup>

11 National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress, vol. 2, 150.

12 IRC § 32. A “qualifying child” is a person who among other things meets age requirements, bears a specified relationship to the taxpayer, and has the same principal residence as the taxpayer for more than half the year. IRC §§ 32(c)(3), 152(c). Married taxpayers can claim EITC only if they file a joint return. IRC § 32(d).

13 For taxpayers with one qualifying child who do not file a joint return, the income limitations for claiming EITC that applied in 2014, 2015, and 2016 were \$38,511, \$39,131, and \$39,296, respectively. Internal Revenue Manual (IRM) 21.6.3.4.2.7.6, *Adjusted Gross Income* (Oct. 1, 2016). Sources for salary data: *North Carolina Public School Salary Schedules*, [www.ncpublicschools.org/fbs/finance/salary/](http://www.ncpublicschools.org/fbs/finance/salary/); *Teacher Elementary School Salaries in San Antonio, Texas*, <http://www1.salary.com/TX/San-Antonio/Teacher-Elementary-School-Salary.html>; National Council on Teacher Quality, *District Policy: Portland Public Schools, OR, Oregon*, <http://www.nctq.org/districtPolicy/contractDatabase/district.do?id=89>; *Red Oak Independent School District 2016-2017 Salary Schedules*, [http://images.pcmac.org/Uploads/RedOakISD/RedOakISD/SubDepartments/DocumentsCategories/Documents/2016-17\\_Teacher\\_Step\\_Pay-n-Salary\\_Structure-071916.pdf](http://images.pcmac.org/Uploads/RedOakISD/RedOakISD/SubDepartments/DocumentsCategories/Documents/2016-17_Teacher_Step_Pay-n-Salary_Structure-071916.pdf); *Public School Teacher Salaries in Harrisburg, Pennsylvania*, <http://www1.salary.com/PA/Harrisburg/Public-School-Teacher-salary.html>; *Parma City Average Teacher Salary & How to Become a Teacher*, <http://www.teachersalaryinfo.com/ohio/teacher-salary-in-parma-city/>; 2012-2016 Teachers’ Agreement Between Glen Ellyn School District 41 Board of Education and Glen Ellyn Education Association, [http://www.d41.org/cms/lib010/IL01904672/Centricity/Domain/429/2012-2016\\_teacher\\_agreement.pdf](http://www.d41.org/cms/lib010/IL01904672/Centricity/Domain/429/2012-2016_teacher_agreement.pdf); National Council on Teacher Quality, *District Policy: Baltimore City Public School System, Maryland*, <http://www.nctq.org/districtPolicy/contractDatabase/district.do?id=34>; New York Office of Salary Services, <http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKEwjEg4n4-oLRAhVlbSYKHfAsB1IQFgghMAE&url=http%3A%2F%2Fschools.nyc.gov%2Fnr%2Frdonlyres%2Ffeddb658c-be7f-4314-85c0-03f5a00b8a0b%2F0%2Fsalary.pdf&usq=AFQjCNEKJwoPeoWQIIzyX5WbiGudAIMdmw&bvm=bv.142059868,d.eWE>; Los Angeles Unified School District Board of Education, *2015-2016 Salaries for Teachers with Regular Credentials (T) C Basis (2%)*; District of Columbia Public Schools, *Compensation and Benefits for Teachers*, <http://dcps.dc.gov/page/compensation-and-benefits-teachers>.

**FIGURE 1.8.3, Entry-Level Salaries for Middle School Teachers in Selected Cities Compared to Income Limitations for Claiming EITC in 2014-2016 for Taxpayers With One Qualifying Child Who Did Not File a Joint Return<sup>14</sup>**

| Forum Location              | Year      | Entry-Level Salary, Middle School Teacher             |
|-----------------------------|-----------|---|
| Parma, OH                   | 2016-2017 | \$33,290  |
| Hendersonville, SC          | 2015-2016 | \$35,000  |
| Portland, OR                | 2015-2016 | \$38,921  |
| Earned income must be below |           | \$38,511 (2014)<br>\$39,131 (2015)<br>\$39,296 (2016) |
| Red Oak, IA                 | 2016-2017 | \$44,000  |
| Harrisburg, PA              | 2016-2017 | \$45,997  |
| Glen Ellyn, IL              | 2014-2015 | \$47,262  |
| Baltimore, MD               | 2016-2017 | \$48,430  |
| San Antonio, TX             | 2016-2017 | \$50,000  |
| Los Angeles, CA             | 2016-2017 | \$50,368  |
| Washington, DC              | 2016-2017 | \$51,359  |
| Bronx, NY                   | 2016-2017 | \$51,650  |

Thus, in eight of the 11 National Taxpayer Advocate Public Forum venues, a middle school teacher earning an entry level salary like Jane would not be eligible to claim the EITC. In the three venues in which entry level salaries for middle school teachers like Jane did not exceed the income limitations for claiming EITC, the teacher would be eligible for EITC, but the most she could receive would be less than \$1,000 — far below the \$3,400 maximum amount of credit available in 2016.<sup>15</sup> For 2014, the most recent year for which data is available, the average amount of EITC paid out was more than \$2,400.<sup>16</sup> Thus, neither actual middle school math teachers nor actual average EITC claimants would be likely to recognize themselves in this vignette.

The vignette goes on to describe how the IRS notifies Jane, via her online account, that she may not qualify for EITC. The reason for the proposed adjustment is not because Jane's income disqualifies her for claiming the EITC, but because Jane's 19-year old son does not appear to be a full-time student, and this, according to the IRS, prevents him from being her qualifying child. Nothing in the vignette allows for the possibility that additional information would change the analysis of whether Jane is entitled to EITC. For example, Jane *would* be eligible for the EITC if her son is permanently disabled, no matter how old he is, and whether or not he is a full-time student.<sup>17</sup>

14 The cities in Figure 1.8.3 were selected because they each served as a venue for the National Taxpayer Advocate Public Forums in 2016.

15 See IRS Form 1040A Instructions *Earned Income Credit (EIC) Table* (assuming Jane's salary as a middle school teacher was her only source of income). The maximum amount of EITC available to taxpayers with one qualifying child who did not file a joint return was \$3,359 in 2015 and \$3,373 in 2016. IRS, *2016 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates*, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts> (last visited Dec. 31, 2016).

16 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc> (last visited Dec. 31, 2016).

17 See IRC §§ 32(a)(3)(C); 152(c)(3)(B).



Nevertheless, in the vignette, Jane ultimately (and seamlessly) uses her online account to “resubmit” her return.<sup>18</sup> The online account in its present form does not give Jane this option. Currently, Jane could only view her balance due and make a payment.<sup>19</sup> When the first release of the technology is complete, Jane would still be able to do only four things via her online account:

- View her balance due;
- Make a payment;
- See payments that have been made; and
- Obtain a transcript of her account.<sup>20</sup>

There is no option for Jane to indicate she does not believe she owes the tax. There are no buttons Jane could click to learn, for example, how to file a protest, how to seek audit reconsideration or penalty abatement, how to file a refund claim, or how to file for “innocent spouse” relief. The National Taxpayer Advocate has urged the IRS to add these features to the online account pages.<sup>21</sup>

The facts in an EITC case are often complex and fluid, since they involve the personal lives of taxpayers. These are not the kind of cases that can be resolved with a one-stop online experience. In fact, the National Taxpayer Advocate has argued consistently that low income taxpayers need the opposite of what the Future State offers, which are customer service approaches fine-tuned to their specific needs and preferences, with an emphasis on communication and education.<sup>22</sup> This is because low income taxpayers, generally speaking, often share a unique set of attributes that may prevent them from navigating the audit process successfully on their own. These attributes include having lower levels of education, being more likely to speak English as a second language, being less likely to have a bank account, and having a higher rate of relocation.<sup>23</sup> The vignette also does not capture taxpayers’ actual experiences when the IRS audits their EITC return.<sup>24</sup>

The National Taxpayer Advocate’s concerns with the vignette were backed up time and time again by practitioners at the recent Public Forums held by the National Taxpayer Advocate. For instance, a tax controversy attorney commented that perhaps Jane’s problem could have been avoided altogether if there

18 This type of self-correction raises additional concerns. See National Taxpayer Advocate 2015 Annual Report to Congress 56, 62 (Most Serious Problem: *As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).

19 The online account is accessed from the payments page on IRS.gov. See *Finding How Much You Owe*, <https://www.irs.gov/payments/finding-out-how-much-you-owe> (last visited Dec. 31, 2016).

20 IRS, *View Your Tax Account Online* (Nov. 21, 2016), <http://win.web.irs.gov/articles/2016/View-your-tax-account-online.htm>.

21 See Most Serious Problem: *Online Accounts: Research Into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *supra*.

22 National Taxpayer Advocate 2015 Annual Report to Congress 245; National Taxpayer Advocate 2012 Annual Report to Congress 103-15; National Taxpayer Advocate 2011 Annual Report to Congress 296-312 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*); National Taxpayer Advocate 2008 Annual Report to Congress 227-42 (Most Serious Problem: *Suitability of the Examination Process*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress, vol. 2, 8-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

23 National Taxpayer Advocate 2015 Annual Report to Congress 235-39.

24 For a full discussion of how the Future State does not reflect taxpayers’ EITC audit experiences, see Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*.

had been more interactive contact either by person-to-person or telephone contact.<sup>25</sup> An attorney from a Low Income Taxpayer Clinic surmised that the IRS's Future State is “more idealized fantasy than accurate portrayal” because it “envision[s] a simple, self-explanatory experience, where the taxpayer is both informed and up-to-date about tax rules and regulations, and is tech-savvy enough to navigate a revised online interface.”<sup>26</sup>

### *Recent Legislative Changes Make Unintentional EITC Errors Very Harmful to Taxpayers*

The Future State plans are not designed to accommodate a legally and factually complex law like the EITC, particularly when any error, whether understood by the taxpayer or not, can affect subsequent years. For instance, Internal Revenue Code (IRC) § 32(k) authorizes the IRS to ban a taxpayer from claiming the EITC for two years if the IRS determines the taxpayer claimed the credit improperly due to reckless or intentional disregard of rules and regulations.<sup>27</sup> Previously, the National Taxpayer Advocate drew attention to the harmful IRS practice of imposing the ban even when the IRS had no interaction with the taxpayer. In particular, a TAS review of the IRC § 32(k) ban showed that the IRS imposed the ban on taxpayers with whom it had had no interaction 49 percent of the time in 2009, 44 percent of the time in 2010, and 39 percent in 2011.<sup>28</sup>

However, when the audit process does not meet taxpayer needs, any EITC denied to the taxpayer (and subsequent bans on future claims) may reflect the taxpayer's inability to navigate the audit process rather than an improper payment.<sup>29</sup> The National Taxpayer Advocate has repeatedly recommended that the IRS hire employees with social work skillsets in order to meet the needs of taxpayers claiming the EITC.<sup>30</sup> At the very least, the IRS can train existing employees in these very skillsets, which will increase their effectiveness in communicating with and assisting this taxpayer population. Poor communication has significant consequences for taxpayers. For example, if a taxpayer who is not eligible for the EITC in the year of audit does not receive a clear explanation as to why she is ineligible, she will likely repeat the same error on her next return. This repetition of the mistake would trigger the two-year ban under IRC § 32(k), even if she becomes eligible in future years. In the Future State plans, the IRS may see more EITC errors as taxpayers are not able to navigate the online tools for self-help on top of an already confusing audit process; alternatively, eligible taxpayers may defer to IRS online tools and thus not receive the EITC benefits to which they are entitled.

The ramifications for taxpayers who make mistakes claiming the EITC are even higher since Congress recently granted IRS the ability to use math error authority in situations where the taxpayer has claimed the EITC during a time that he or she is barred from doing so under IRC § 32(k).<sup>31</sup> Math error authority allows the IRS to correct mathematical errors and inconsistencies on a return which may result in a tax

25 Oral Statement of Elizabeth Atkinson, Attorney, National Taxpayer Advocate Public Forum 27 (May 13, 2016).

26 Oral Statement of Robert Hamilton, Attorney, National Taxpayer Advocate Public Forum 13 (Apr. 8, 2016).

27 IRC § 32(k)(1)(B)(ii) provides for a two-year “disallowance period” of “two taxable years after the most recent taxable year for which there was a final determination that the taxpayer’s claim of credit under this section was due to reckless or intentional disregard of rules and regulations.”

28 National Taxpayer Advocate 2013 Annual Report to Congress 105.

29 National Taxpayer Advocate 2011 Annual Report to Congress 301.

30 Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*; National Taxpayer Advocate 2015 Annual Report to Congress 261; National Taxpayer Advocate 2010 Annual Report to Congress 15-27.

31 Protecting Americans from Tax Hikes (PATH Act) of 2015, Pub. L. No. 114-113, div. Q, title 2, § 208, 129 Stat. 3083.

increase or a tax decrease.<sup>32</sup> It is now possible that a taxpayer who made an error claiming the EITC but is eligible for it in the future, will be denied the credit in subsequent years by math error authority. With the EITC vignette described above, a taxpayer who continues to pursue his or her EITC claim despite the electronic notification from the IRS may be deemed to be exhibiting reckless behavior under IRC § 32(k).

Taxpayers who make mistakes claiming the EITC will also incur costs from penalty assessments. Prior to December 18, 2015, the Tax Court ruling in *Rand v. Commissioner* held that refundable credits (such as the EITC) could not reduce below zero the amount shown as tax by the taxpayer on a return.<sup>33</sup> The amount of tax shown by the taxpayer on a return is an important element in calculating an underpayment of tax, which in turn serves as the basis for the accuracy-related penalty under IRC § 6662.<sup>34</sup>

However, recently enacted law reversed the Tax Court's decision in *Rand v. Commissioner*, and amended IRC § 6664(a) to be consistent with the rule of IRC § 6211(b)(4), which will allow the IRS to calculate negative tax in computing the amount of underpayment for accuracy-related penalty purposes.<sup>35</sup> Thus, for returns filed after December 18, 2015, or for returns filed before that date for which the period of limitations on assessment under IRC § 6501 has not expired, a taxpayer can be subject to an underpayment penalty in IRC § 6662 based on an EITC claim which reduces tax below zero.

### *The IRS Has Proceeded With the Future State Plans Without Researching or Addressing How It Will Affect Low Income Taxpayers*

Given the harms that can befall a taxpayer claiming the EITC, this is a time when taxpayers need to have sufficient, one-on-one assistance with their initial EITC claims. The IRS needs to speak with and engage these taxpayers because EITC cases are complex. This is not a time to reduce assistance to low income taxpayers in the name of efficiency, especially since the IRS does not know what impact the Future State will have on low income taxpayers.

TAS is conducting a study to evaluate the compliance impact of education and outreach on potentially noncompliant EITC taxpayers.<sup>36</sup> TAS Research identified EITC taxpayers who were audited in 2015 and others who were not, but who had similar risk scores to the taxpayers who were audited. TAS then developed three representative samples from this population:

- Audit Group: This group was comprised of taxpayers who were audited in 2015.
- Test Group: This group was comprised of taxpayers who were not audited in 2015, but with similar risk scores to the taxpayers who were audited. The National Taxpayer Advocate sent letters highlighting potential errors to this group at the beginning of the 2016 filing season.

32 Generally, IRC § 6212 requires that prior to assessment of a liability the IRS must send a notice of deficiency to the taxpayer via certified mail. This notice provides the taxpayer with the right to petition the U.S. Tax Court, the only opportunity for judicial review without first paying the tax. IRC § 6213. However, IRC § 6213, in subsections (b) and (g), authorizes the IRS to use its math error authority to summarily assess tax and bypass normal deficiency procedures. Summary assessments made under these provisions can be abated if the taxpayer timely requests abatement. IRC § 6213(b)(2)(A). The IRS will then work the case through normal deficiency procedures. IRC § 6213(b)(2)(A).

33 *Rand v. Comm'r*, 141 T.C. 376 (2013). See also National Taxpayer Advocate 2014 Annual Report to Congress 449.

34 IRC § 6664(a).

35 Pub. L. No. 114-113, Consolidated Appropriations Act, 2016 (Division Q, PATH Act of 2015), § 209, 114th Cong. (Dec. 18, 2015).

36 See Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*, vol. 2, *infra*; National Taxpayer Advocate FY 2017 Objectives Report to Congress, vol. 2, 185.

- Control Group: This group was also comprised of taxpayers not audited in 2015, but with similar risk scores to the taxpayers who were audited or sent a TAS letter.

In January 2015, the National Taxpayer Advocate sent about 7,100 letters to the taxpayers who were not audited but appeared to have erroneously claimed EITC on their 2014 returns.<sup>37</sup> The letters were specifically designed to inform and educate taxpayers with targeted and specific information about EITC eligibility rules, geared to the error the IRS identified. The letters explained their purely educational purpose, and clearly stated that this contact was not an audit. For those taxpayers who received Title IV benefits (Temporary Assistance for Needy Families, *etc.*), the letter included a sentence reminding them that the eligibility rules for EITC were different from the rules for Title IV benefits, so a taxpayer could receive Title IV benefits for a child and yet not be eligible for the EITC with respect to that same child. TAS then compared the level of compliance shown on taxpayers' 2016 returns among three groups:

- Taxpayers who were not audited but were sent the TAS letter;
- A representative sample of taxpayers whose 2014 returns were audited; and
- A representative sample of taxpayers whose 2015 returns appeared to erroneously claim the EITC but who were not audited and did not receive the TAS letter.<sup>38</sup>

The TAS letter, intended to educate taxpayers about the requirements for claiming EITC, appeared to help taxpayers avoid repeating their mistakes.<sup>39</sup> Taxpayers who were sent a TAS letter were less likely to file a 2015 return that repeated the apparent error of not meeting the relationship test, compared to unaudited taxpayers who were not sent a TAS letter.

TAS is planning to repeat the letter test in the 2017 filing season. TAS will add an additional sample of taxpayers who will be offered, in the letter, the availability of a dedicated "Extra Help" line staffed by trained TAS employees who can answer taxpayer questions about the letter and the EITC eligibility rules. TAS will be tracking the compliance behavior of that cohort as well, and report on that in the 2017 Annual Report to Congress.

While the IRS has not collected any data to show the impact of the Future State on low income taxpayers, there is some data to suggest it will be harmful to many in the low income taxpayer population. As the IRS moves away from traditional in-person services such as live telephone assistance or face-to face, the transition will impact some groups of taxpayers more than others.<sup>40</sup> Research conducted by the Pew Research Center (Pew) confirms that internet use varies across different groups.

- In 2013, a Pew survey revealed that 44 percent of adults with no high school diploma reported not going online whereas only seven percent of adults with some college reported not going online.<sup>41</sup>
- In 2014, Pew found that only 77 percent of adults with household income less than \$30,000 per year went online but 99 percent of adults with household income of \$75,000 or more went online.<sup>42</sup>

37 See Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*, vol. 2, *infra*.

38 *Id.*

39 *Id.*

40 National Taxpayer Advocate 2014 Annual Report to Congress 11.

41 Pew Research Center (Pew), *Offline Adults* (2013), <http://www.pewinternet.org/data-trend/internet-use/offline-adults/> (last visited Dec. 31, 2016).

42 Pew, *Internet User Demographics* (2014), <http://www.pewinternet.org/data-trend/internet-use/latest-stats/> (last visited Dec. 31, 2016).

- Over 90 percent of Americans under the age of 50 report going online whereas less than half of Americans over the age of 80 use the internet.<sup>43</sup>

Even when a taxpayer can access the internet, it does not mean that access is adequate. In 2015, only 67 percent of all adults reported having broadband access in the home.<sup>44</sup> A lack of broadband in the home was identified as a disadvantage to getting tasks done.<sup>45</sup> According to Pew surveys, 43 percent of non-broadband adopters say that cost is the primary reason why they do not currently have broadband.<sup>46</sup> Instead, “many of those non-broadband adopters are now turning to their smart phones and other mobile devices to bridge those gaps.”<sup>47</sup> Having to rely on a smart phone or similar device for complex tasks can be difficult because of the small screen and the requirement that the user find a public space providing service, such as a coffee shop.<sup>48</sup>

In 2015, the United Kingdom’s tax authority, Her Majesty’s Revenue and Customs (HMRC), announced “the end of the tax return” as it set out to modernize its tax system.<sup>49</sup> By 2020, HMRC plans to have a fully digital system where taxpayers will have their own accounts to register, file, pay, and update their information at any time.<sup>50</sup> The initiative made a commitment to have “good customer service at its heart.”<sup>51</sup> HMRC acknowledges that even with the convenience of digital services, some taxpayers need additional support. As a result, HMRC plans to offer alternative options for assistance, including over the phone, face-to-face visits, and partners in the community.<sup>52</sup> Most significantly, unlike in the United States, 89 percent of households in Great Britain have an internet connection and 93 percent of those households have broadband.<sup>53</sup>

#### TAXPAYER DIGITAL COMMUNICATION

It is important that the IRS understands the needs and preferences of the taxpayers who will be using the digital features of the Future State.<sup>54</sup> Taxpayer Digital Communication (TDC) is a pilot project, slated to begin in the first quarter of FY 2017, which TAS continues to develop in conjunction with IRS Online Services.<sup>55</sup> Under this initiative, taxpayers will have the ability to communicate with their assigned

43 Oral statement of Aaron Smith, Associate Director, Pew Research Centers, National Taxpayer Advocate Public Forum 153 (Feb. 23, 2016).

44 Pew, *Home Broadband 2015* (Dec. 21, 2015), <http://www.pewinternet.org/2015/12/21/home-broadband-2015/> (last visited Dec. 31, 2016).

45 Oral statement of Aaron Smith, Associate Director, Pew Research Centers, National Taxpayer Advocate Public Forum 155 (Feb. 23, 2016). The Federal Communications Commission (FCC) demonstrates the difference between broadband access and the alternative, dial-up access, by offering this explanation: “Every page, image and video on the web comes to your home device as small pieces of data, or packets. How fast these packets move on the network is measured in Megabits per second, abbreviated Mbps. Broadband technology can move those packets to and from your home much more quickly than dial-up access using a modem and telephone line.” FCC, *Broadband Service for the Home: A Consumer’s Guide*, <https://www.fcc.gov/research-reports/guides/broadband-service-home-consumers-guide> (last visited Dec. 31, 2016).

46 Oral statement of Aaron Smith, Associate Director, Pew, National Taxpayer Advocate Public Forum 155 (Feb. 23, 2016).

47 *Id.*

48 *Id.* at 158.

49 Her Majesty’s Revenue and Customs (HMRC), *Making Tax Easier: the End of the Tax Return 1* (Mar. 2015).

50 HMRC, *Making Tax Digital 4* (Dec. 2015).

51 HMRC, *Making Tax Easier: the End of the Tax Return 1* (Mar. 2015).

52 HMRC, *Making Tax Digital 6* (Dec. 2015).

53 Office for National Statistics, *Internet Access: Households and Individuals: 2016* 25-29 (Aug. 4, 2016). Internet access in Great Britain is tied to age. Only 53 percent of households with one adult aged 65 or older has internet access. Office for National Statistics, *Internet Access: Households and Individuals: 2016* 29 (Aug. 4, 2016).

54 See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*, *supra*.

55 See National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 198.

TAS case advocate using a secure web-based portal that allows one-way and two-way communication, including live text chat, voice chat, video chat, and screen sharing. TDC also plans to deliver notifications and alerts by text message and feature smart phone interactivity. The pilot is designed to test whether TDC enhances communication and information sharing between TAS employees and taxpayers. TAS plans to pilot the portal to process EITC cases in four TAS offices.

The goal of testing EITC cases is to see if taxpayers can create online accounts and get through the three-factor verification process. Currently, the “pass rate” for taxpayers attempting to create an online IRS account is 28 percent.<sup>56</sup> The pass rate for low income taxpayers will most assuredly be lower, because they do not possess many of the financial attributes the verification process requires. Of those taxpayers who can create an online account, TAS will gather more details about their experience. For instance, TAS will attempt to answer these questions:

- Were taxpayers able to access their accounts in a timely manner;
- Were taxpayers able to use their accounts as intended;
- Did taxpayers communicate well via email and were they more responsive than regular mail;
- Did taxpayers respond and provide documentation more quickly via email than through regular mail;
- Did taxpayers understand what the IRS and TAS sent to them;
- Were taxpayers unwilling to use the online account (instead relying on telephone contact with the IRS); and
- Did taxpayers have a higher relief rate using the online account versus traditional contacts?

The National Taxpayer Advocate anticipates having this data by the end of 2017, which will shed light on the ability of over 27 million EITC taxpayers to participate in the IRS Future State. Given all of the concerns discussed above, the IRS should postpone its planning of any EITC Future State technology until the TDC data is available. Instead, the IRS should invest its resources into person-to-person communication for EITC taxpayers, including an “Extra Help” line.

## CONCLUSION

The National Taxpayer Advocate is concerned that the IRS may make the EITC out of reach for taxpayers with its Future State plans. Since the Future State relies on online services and self-help capabilities, the IRS may be creating a situation where many low income taxpayers who require personalized assistance are left to fend for themselves or pay for assistance from unregulated preparers. This may prevent eligible taxpayers from receiving the credit and will do nothing to improve the improper payment rate. This is happening at a time when unintentional errors claiming the EITC will have drastic consequences for taxpayers, including a future ban that can be imposed with more ease, and penalties that up until now have not been considered. The IRS has not collected sufficient data to determine if the Future State will be compatible with the needs of low income taxpayers, and what data is available clearly indicates it is not compatible. Given that the Future State could be negatively impacting one of the largest anti-poverty programs, the IRS should postpone its implementation for EITC purposes until it understands how this will affect low income taxpayers.

<sup>56</sup> National Taxpayer Advocate Notes from Services and Enforcement Executive Steering Committee Meeting (Nov. 17, 2016).



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Amend Internal Revenue Manual 4.19.14.5.4, *EITC Qualifying Child*, to allow an IRS employee to use a state agency's determination that a taxpayer has qualified for Temporary Assistance for Needy Families, Section 8 or comparable benefits, as substantiation for EITC with a qualifying child.
2. Hire or train employees with social work skillsets in order to meet the needs of taxpayers claiming the EITC.
3. Postpone its planning of any EITC Future State technology until the TDC data is available. Instead, the IRS should invest its resources into person-to-person communication for EITC taxpayers, including a dedicated "Extra Help" line for EITC taxpayers.

**MSP  
#9****FRAUD DETECTION: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM<sup>2</sup>**

Over the past decade, fraud and identity theft have increasingly plagued consumers, businesses, and financial institutions.<sup>3</sup> The IRS has also been impacted. A 2015 Treasury Inspector General for Tax Administration (TIGTA) report found that the IRS processed approximately 1.5 million returns for tax year (TY) 2010 with characteristics of identity theft, issuing potentially fraudulent refunds totaling \$5.2 billion.<sup>4</sup>

To detect and prevent identity theft and other tax refund fraud, the IRS has established a complicated screening process.<sup>5</sup> When a return is flagged by one of the multiple IRS systems that scrutinize returns for characteristics of refund fraud or identity theft, the refund is held until the taxpayer can authenticate

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Reducing "False Positive" Determinations in Fraud Detection*, vol. 3, *infra*.

3 See also American Bankers Association (ABA), *Banks Stop \$11 Billion in Fraud Attempts in 2014* (Jan. 27, 2016), <http://www.aba.com/press/pages/012716depositsurvey.aspx>. While attempted fraud against bank deposit accounts reached \$13 billion, banks' prevention measures stopped \$11 billion in fraudulent transactions. Bureau of Justice Statistics (Sept. 27, 2015), [www.bjs.gov](http://www.bjs.gov). An estimated 17.6 million persons, or about seven percent of U.S. residents age 16 or older, were victims of at least one incident of identity theft in 2014.

4 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft* (Apr. 24, 2015).

5 The IRS Return Integrity & Compliance Services (RICS) uses three independent systems to identify returns when it suspects identity theft has occurred or that the return is fraudulent — the Dependent Database (DDb), the Return Review Program (RRP), and the Electronic Fraud Detection System (EFDS).

his or her identity, or until the information on the return can be verified.<sup>6</sup> Although these systems do identify improper returns and prevent improper refunds from being issued, they also have a high degree of inaccuracy, which results in unnecessary refund delays and reduced taxpayer morale.<sup>7</sup>

Over the past 13 years, the National Taxpayer Advocate has consistently advocated for taxpayers whose legitimate refunds have been unreasonably delayed by the IRS and recommended improvements to reduce taxpayer burden while preventing identity theft and refund fraud.<sup>8</sup>

The National Taxpayer Advocate remains concerned that:

- IRS fraud detection systems have a high false positive rate (FPR).<sup>9</sup> For calendar year (CY) 2016 through September, IRS filters and business rules used for detecting fraudulent returns and identity theft had many FPRs over 50 percent. These improper selections delayed approximately 1.2 million tax returns associated with about \$9 billion in legitimate refunds for more than an additional 30 days on average. Notably, one IRS process for reviewing returns for identity theft had an FPR of roughly 91 percent.<sup>10</sup>
- The issuance of refunds that were improperly identified by IRS systems as being returns likely resulting from identity theft or fraud was significantly delayed. On average, these refunds were delayed an additional 36 days, meaning it took taxpayers nearly two months to receive their refunds.<sup>11</sup>

6 The IRS has distinct screening processes for identity theft and refund fraud. For purposes of this report, we will refer to refund fraud in its broadest sense, to include identity theft as a subset of refund fraud. See also National Taxpayer Advocate 2015 Annual Report to Congress 45-55 (Most Serious Problem: *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program*). The IRS uses identity theft filters to select and suspend the processing of tax returns it suspects were filed by identity thieves. When the IRS stops a return, it will send the taxpayer a letter asking him or her to either call the Taxpayer Protection Program (TPP) phone number, visit the ID verify website, or appear in person at a Taxpayer Assistance Center (TAC) to verify his or her identity. Internal Revenue Manual (IRM) 25.25.6.1, *Taxpayer Protection Program* (May 26, 2015).

7 Gregg S. Henzel et al., *Using Model Calibration and Optimization to Reduce Fraud Risk: How Financial Institutions Can Identify Fraud More Effectively While Reducing Costs* 3-4 (Crowe Horwath 2015), <https://www.crowehorwath.com/folio-pdf/Using-Model-Calibration-and-Optimization-to-Reduce-Fraud-Risk-Article-RISK-16007-008A.pdf>. See also Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called "Enforcement" Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*.

8 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress, 45-55, 180-87; National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67, 95-110; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-17; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 25-54, 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36; and National Taxpayer Advocate 2003 Annual Report to Congress 175-81.

9 A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. IRS response to TAS information request (Nov. 3, 2016).

10 *Id.* The returns reviewed by this process include taxpayers who have previously been victimized by identity theft, and therefore these filters are more stringent, which may account in part for this high false positive rate (FPR).

11 *Id.* The normal timeframe for processing a refund is 21 days. These refunds were delayed 36 days beyond that normal processing time, meaning that the average processing time for these refunds was 57 days. See IRS Newswire, *As Holidays Approach, IRS Reminds Taxpayers of Refund Delays in 2017*, IR-2016-152 (Nov. 22, 2016). "As the IRS steps up its efforts to combat identity theft and tax refund fraud through its many processing filters, legitimate refund returns sometimes get delayed during the review process."

- IRS fraud detection systems are antiquated and the IRS's ability to adjust the systems in real time is limited, placing them outside the industry standard for fraud detection systems.<sup>12</sup>

IRS systems that improperly flag legitimate tax returns and delay refund issuance can create a financial hardship for taxpayers, expend unnecessary IRS resources to resolve the issues, and negatively impact taxpayers' voluntary compliance. Thus, as literature has shown, in order to reduce FPRs, it is extremely important that the IRS identify the necessary elements to establish a robust fraud detection system.<sup>13</sup> This objective can be met by regularly consulting with other government entities and private industry about best practices for effectively designing systems to accurately detect fraud. Through this process, the IRS should establish aspirational goals for reducing FPRs. This goal is within reach after Congress passed legislation moving the deadline for third-party information reporting up from the end of February (and the end of March for electronic filers) to January 31, providing the IRS more time to match the wage and tax information reported on the taxpayer's return against the information submitted by third parties.<sup>14</sup>

## ANALYSIS OF PROBLEM

### Background

The return integrity program, a process critical to the IRS's strategy to address identity theft and detect and prevent improper fraudulent refunds, is complex and multifaceted.<sup>15</sup> The Return Integrity & Compliance Services (RICS) Integrity and Verification Operation (IVO) — a part of the Wage & Investment (W&I) Division — uses filters, rules, data mining models, and manual reviews to identify potentially false returns, usually through wages or withholding reported on the returns, to stop fraudulent refunds before the IRS issues them.<sup>16</sup>

The IRS electronically screens tax returns using three independent systems: the Dependent Database (DDb), the Return Review Program (RRP), and the Electronic Fraud Detection System (EFDS).<sup>17</sup> If one of these systems flags a return as potentially fraudulent, the return goes to the Taxpayer Protection Program (TPP) or the Income Wage Verification (IWV) program for further scrutiny.

In addition to the RICS programs, the IRS began employing additional filters known as the Identity Theft business rules in January 2009. The business rules are applied to any return filed with a Social Security number (SSN) associated with an identity theft indicator. These returns are not allowed to post

12 "The heart of an efficient fraud prevention solution is a strong analytics engine, which can use the available data intelligently, recognize and identify patterns, provide real time visibility into threats, and signal discrepancies. It should enable the solution to detect and respond swiftly to suspicious or fraudulent transactions." Vasudevan Easwaran, *The Combination to a Safe Future for Banking Using Technology in the Banking Industry to Prevent Fraud*, WIPRO (2015).

13 See Literature Review: *Reducing "False Positive" Determinations in Fraud Detection*, vol. 3, *infra*.

14 Section 201 of the Protecting Americans From Tax Hikes (PATH) Act amended IRC § 6071 to require that certain information returns be filed by January 31, generally the same date as the due date for employee and payee statements, and are no longer eligible for the extended filing date for electronically filed returns under section 6071(b). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015). This legislative change is consistent with prior National Taxpayer Advocate recommendations. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 45-55; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-88; National Taxpayer Advocate 2012 Annual Report to Congress 180-91; National Taxpayer Advocate 2011 Annual Report to Congress 284-95; National Taxpayer Advocate 2009 Annual Report to Congress 338-45.

15 Internal Revenue Manual (IRM) 25.25.1.1 (Feb. 19, 2015).

16 IRM 25.25.2.1(1) (Aug. 20, 2015).

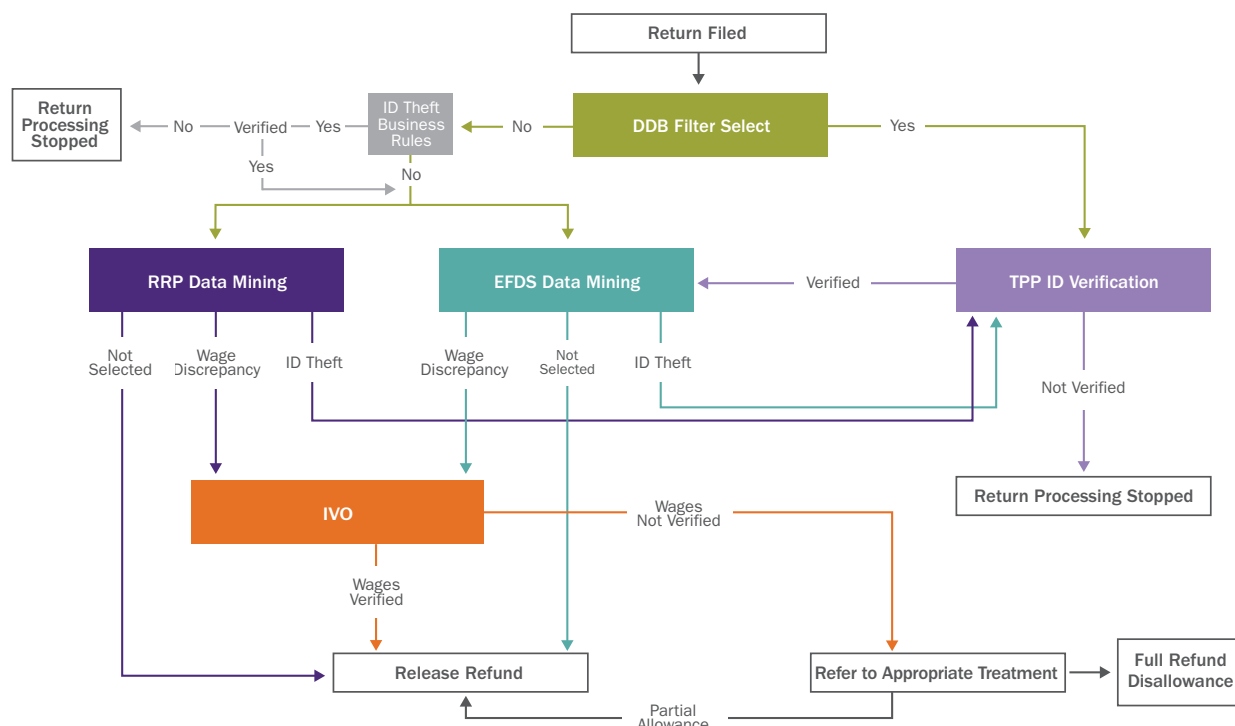
17 IRM 25.25.6.1 (Aug. 26, 2016).

to taxpayers' accounts (these are called “unpostable” returns) until the IRS can review the returns and accounts, and determine that they belong to the valid SSN owners.<sup>18</sup>

Figure 1.9.1 provides a simplified flow chart of the complicated processes the IRS uses to screen returns claiming refunds for identity theft and fraud.

**FIGURE 1.9.1**

**Flow Chart of Refund Return Screening for Identity Theft and Fraud**



As illustrated above, when a refund return is subject to the TPP, it will first be analyzed by the DDb system which will look for identity theft characteristics. As of CY 2016 through September, the DDb system has selected 1,184,976 returns with an FPR of 49 percent, and the affected returns took an average of 57 days to be processed.<sup>19</sup>

The RRP will select returns for both the TPP and the IWV programs. RRP then generates scores that relate to the predictive value of possible identity theft or fraud, or both.<sup>20</sup> For CY 2016 through

<sup>18</sup> National Taxpayer Advocate 2009 Annual Report to Congress 307-17.

<sup>19</sup> IRS response to TAS information request (Nov. 3, 2016). The IRS generally allows 21 days for a return to be processed. The processing of these returns took about 36 days beyond the normal 21 day processing time, meaning that the total return processing time for these returns was about 57 days. After the return is scrutinized by the DDb system, returns filed with an Social Security number associated with the identity theft indicators are subjected to a separate set of business rules. For calendar year (CY) 2016 through September, the IRS suspended the processing of 736,111 returns that did not pass the business rules with an FPR of 91 percent and an average processing delay of 30 days. The IRS has committed to eliminating the business rules that are outside of the TPP in CY 2017.

<sup>20</sup> See TIGTA, Ref. No. 2015-20-060, *The Return Review Program Enhances the Identification of Fraud; However, System Security Needs Improvement* (July 2, 2015).

IRS fraud detection systems have a high false positive rate (FPR). For calendar year 2016 through September, IRS filters and business rules used for detecting fraudulent returns and identity theft had many FPRs over 50 percent. These improper selections delayed approximately 1.2 million tax returns associated with about \$9 billion in legitimate refunds for more than an additional 30 days on average. Notably, one IRS process for reviewing returns for identity theft had an FPR of roughly 91 percent.

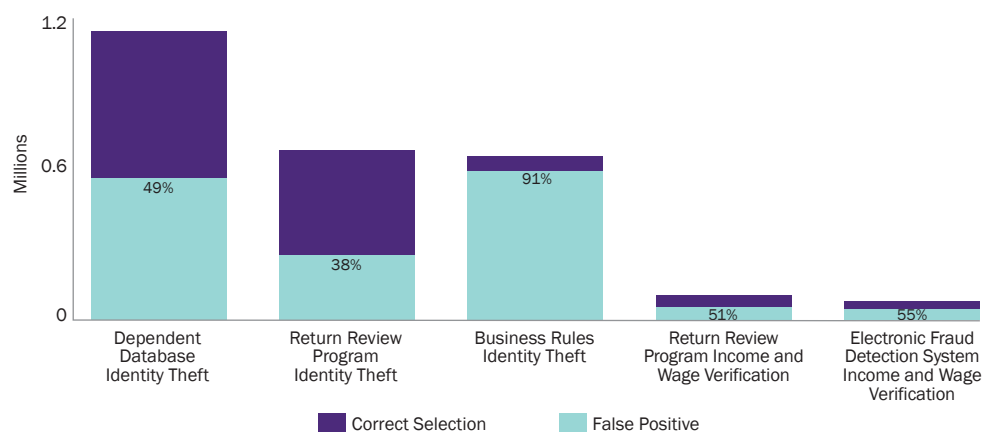
September, RRP has selected 698,960 returns for potential identity theft with an FPR of 37.9 percent, and the affected returns took an average of 57 days to be processed (*i.e.*, this system scrutinizes returns for both identity theft or fraud).<sup>21</sup> Likewise, RRP selected 103,520 returns for potential refund fraud during the same period. The FPR for improperly selected refund fraud returns was 50.6 percent.<sup>22</sup>

The EFDS program will run simultaneously with the RRP program. EFDS uses data mining models to score each Form W-2 and 1099 on refund returns for fraud potential based on business rules that consider return and filing characteristics.<sup>23</sup> For CY 2016 through September, EFDS has selected 77,810 returns with an FPR of 54.5 percent, and the affected returns took an average of 55 days to be processed.<sup>24</sup>

Figure 1.9.2 shows the volume and false positive rates for the above-mentioned IRS identity theft and fraud detection systems.<sup>25</sup>

**FIGURE 1.9.2**

**Program Volumes and False Positives 2016 (through September)**



21 IRS response to TAS information request (Nov. 3, 2016).

22 *Id.*

23 IRS response to TAS information request (Aug. 20, 2015). IRM 25.25.2.1 (Aug. 20, 2015).

24 IRS response to TAS information request (Nov. 3, 2016).

25 *Id.*



It appears that the IRS has accepted these FPRs as a necessary byproduct of risk detection, viewing the harm to legitimate taxpayers as a minor inconvenience. However, other government agencies, such as the U.S. Citizenship and Immigration Service (USCIS), are making efforts to improve error rates to as little as three percent.<sup>26</sup> The National Taxpayer Advocate realizes that identifying fraud and identity theft in tax administration is likely much different from the processes established by USCIS, but it illustrates the point that other government agencies are interested and motivated to reduce FPRs.

### IRS Systems Are Antiquated and Lack the Nimbleness Necessary to Function in an Ever Changing World of Fraud and Identity Theft

The high false positive rates set out above result in thousands of taxpayers with legitimate returns being subjected to a frustrating and often elusive process. If the IRS is scrutinizing the return for possible identity theft, the taxpayer will likely be instructed to contact the IRS's dedicated Taxpayer Protection Program line, which had a Level of Service of 31.7 percent for fiscal year 2016 and a wait time of almost 11 minutes.

The IRS's EFDS system is incapable of having its filters adjusted regularly.<sup>27</sup> However, the DDb and RRP systems are capable of having their filters adjusted.<sup>28</sup> DDb filters are able to be changed, if needed, on a weekly basis, and RRP has set aside programming dates to make that kind of change during the filing season.<sup>29</sup> Despite the systems' abilities to have their filters changed to address emerging circumstances, the IRS has established a cumbersome and laborious process for such changes to occur. For instance, any changes to the RRP must receive approval from the Business Rules and Requirements Management (BRRM) office, and any changes to the DDb are subject to a different process.<sup>30</sup> BRRM does not meet regularly; therefore, any change request that needs immediate attention must go through a time-consuming approval process resulting in more refund delays. Creating a sub-approval group authorized to implement real-time modifications to screening rules and filters would allow for faster resolution of systemic issues and minimization of taxpayer harm. Such an approach would better align the IRS with accepted private industry practices to detect and prevent fraud. Specifically, experts in this area advise that designing an organizational structure that allows sharing of information in real time enables all necessary stakeholders to evaluate and adjust an organization's fraud detection systems and filters based on this information.<sup>31</sup> In fact, for identity theft and fraud detection systems to be effective, the organization's leaders must accept that some traditional implementation and support processes are too slow to react to actions of fraud groups.<sup>32</sup>

Furthermore, having a large number of stakeholders involved in the decision-making process runs a "risk of over-governance resulting in duplication, inefficiencies, and uncertainty relating to ownership of fraud

26 *E-Verify Progressing, but Still Needs Work*, GAO Finds, CQ HOMELAND SECURITY (CONGRESSIONAL QUARTERLY, Washington, DC) (Jan. 20, 2011).

27 TIGTA, Ref. No. 2015-20-093, *Review of the Electronic Fraud Detection System* (Sept. 2015) (stating that EFDS is modified annually).

28 IRS response to TAS information request (Nov. 3, 2016).

29 *Id.*

30 IRM 1.1.13.6.3.4 (Oct. 7, 2013). The office is responsible for the coordination and execution of the activities required to define, develop, maintain, and control business requirements and rules.

31 Deloitte, *The Latest Tools and Tactics for Battling Bank Fraud 3* (May 1, 2014), <http://deloitte.wsj.com/cio/2014/05/01/the-latest-tools-tactics-for-battling-bank-fraud/> (Dec. 31, 2016).

32 *Id.*

detection issues needing resolution.”<sup>33</sup> The heart of an efficient fraud prevention solution is a strong analytics engine, which can use the available data intelligently, recognize and identify patterns, provide real time visibility into threats, and signal discrepancies.<sup>34</sup> It should enable the solution to detect and respond swiftly to suspicious or fraudulent transactions.<sup>35</sup> It appears that while the IRS’s DDb and RRP systems have the analytic capabilities necessary for a successful fraud and identity theft detection system, the IRS is not taking full advantage of these capabilities. Instead, the IRS adheres to a cumbersome process for changing system filters, thereby limiting the system abilities to respond to changing circumstances in real time.

In addition to IRS systems lacking the capability to adjust in real-time, another significant drawback is system limitations towards analyzing information simultaneously. As described above, IRS systems work independently from one another, thereby extending the time for a return to be analyzed, resulting in additional refund delays and frustrated taxpayers.

### *Continuing and Enhancing Collaboration in the Form of Public-Private Partnerships Can Leverage the IRS’s Ability to Fight Identity Theft and Refund Fraud*

The literature<sup>36</sup> has shown that in the financial sector, a system developed to detect fraud normally contains the following four elements:

- Detect: predict fraud before it happens;
- Respond: apply new fraud insights;
- Investigate: turn fraud intelligence into action; and
- Discover: leverage existing historical data.<sup>37</sup>

Any successful fraud detection system should also contain a combination of the following types of analytics:

- *Advanced Analytics*: Critical data drawn from across the enterprise can be centralized in a flexible framework that, unlike more limiting relational databases, can accommodate multiple data formats in a production environment.<sup>38</sup>
- *Behavioral Analytics*: Behavioral analytics solutions are designed to understand the normal behavior of each individual consisting of a detailed, multi-faceted combination of timing, sequence, devices, locations, channels, and the financial and non-financial activities performed via those channels.<sup>39</sup>

33 Australian Government, Inspector-General of Taxation, *Review into the Australian Taxation Office’s Compliance Approach to Individual Taxpayers Income Tax Refund Integrity Program* 13 (Sept. 2013), <http://igt.gov.au/files/2014/11/income-tax-refund-integrity-program.pdf>.

34 Vasudevan Easwaran, *The Combination to a Safe Future for Banking Using Technology in the Banking Industry to Prevent Fraud*, WIPRO (2015).

35 *Id.*

36 See, e.g. IBM Software, *Fighting Fraud in Banking with Big Data and Analytics* (Oct. 2014), discussed in Literature Review: *Reducing “False Positive” Determinations in Fraud Detection*, vol. 3, *infra*.

37 IBM Software, *Fighting Fraud in Banking with Big Data and Analytics* (Oct. 2014).

38 Deloitte, Chief Information Officer (CIO) News, CIO Insight and Analysis, WALL STREET JOURNAL, *The Latest Tools and Tactics for Battling Bank Fraud* 2 (May 1, 2014), <http://deloitte.wsj.com/cio/2014/05/01/the-latest-tools-tactics-for-battling-bank-fraud/>.

39 Craig Priess, *Behavioral Analytics for Detecting Fraud* 2 (Mar. 18, 2015), <https://www.bai.org/banking-strategies/article-detail/behavioral-analytics-for-detecting-fraud>.

- *Transaction Analytics*: This technique allows financial institutions to analyze their customers' detailed transaction data over time to gain an understanding of purchasing patterns and behaviors.<sup>40</sup>
- *Anomaly Analytics*: This analytical technique is focused on detecting inconsistencies with previously demonstrated "normal" patterns of behavior.<sup>41</sup>

Although the IRS uses some of these analytic techniques in its fraud detection systems, its systems still have limitations, such as their inability to share information with one another, essentially only allowing these systems to operate in a vacuum. Therefore, the IRS should continue and enhance its collaboration with experts in the financial industry, including the Federal Financial Institutions Examination Council (FFIEC),<sup>42</sup> to identify necessary elements of a robust fraud detection system and learn from private sector and other tax administration experiences to establish best practices for its fraud detection programs. A good example of IRS's collaboration with states and industry partners is the IRS Security Summit.<sup>43</sup>

The National Taxpayer Advocate commends the IRS for its involvement in the Security Summit, but encourages the IRS to leverage private partnerships to a greater extent, to identify industry standards for designing and implementing fraud detection systems that are modern and effective. Additionally, the IRS should establish partnerships with other government agencies, such as the Defense Intelligence Agency, that use data mining and risk detection in an effort to learn more about successful government systems and processes.

### IRS's Outdated Systems That Generate High FPRs Result in a High Price for Both Taxpayers and the IRS

#### *IRS Systems with High FPRs Harm Legitimate Taxpayers by Significantly Delaying Their Refunds and Entangling Them in an IRS System That Is Challenging to Navigate*

The high FPRs set out above result in thousands of taxpayers with legitimate returns being subjected to a frustrating and often elusive process. If the IRS is scrutinizing the return for possible identity theft, the taxpayer will likely be instructed to contact the IRS's dedicated TPP line, which had a Level of Service (LOS) of 31.7 percent for fiscal year (FY) 2016 and a wait time of almost 11 minutes.<sup>44</sup> If the taxpayer's return was being scrutinized for refund fraud, the taxpayer would call into Accounts Management, which had a LOS of 53.4 percent for FY 2016 and a wait time of almost 18 minutes.<sup>45</sup> If a taxpayer tries to get

40 Dean Nolan, *Combating Fraud with Transaction Analytics* (Apr. 2, 2014), <https://www.bai.org/banking-strategies/article-detail/combating-fraud-with-transaction-analytics>.

41 The power of anomaly detection lies in the fact that it doesn't matter how the account is compromised - whether it's a Trojan or other malware, stolen credentials, or social engineering through customer service — the suspicious behavior relative to established norms is what provides a clue or signals that something is amiss. Guardian Analytics, *Best Practices for Detecting Banking Fraud*, 2013, [http://www.cbai.com/news/Best\\_Practices\\_for\\_Detecting\\_Fraud\\_white\\_paper.pdf](http://www.cbai.com/news/Best_Practices_for_Detecting_Fraud_white_paper.pdf). For a more in depth discussion about how private industry has leveraged modern technology to detect and prevent identity theft and fraud, see Literature Review: *Reducing "False Positive" Determinations in Fraud Detection*, vol. 3, *infra*.

42 The Federal Financial Institutions Examination Council, <https://www.ffiec.gov/>.

43 See IRS, *Security Summit Partners Update Identity Theft Initiatives for 2017*, FS-2016-21, June 2016, <https://www.irs.gov/uac/security-summit-partners-update-identity-theft-initiatives-for-2017> (last visited Dec. 31, 2016). The IRS Security Summit allows partners to identify possible identity theft (IDT) schemes and report them to the IRS and state partners to help them stay on top of emerging schemes; increases public awareness about the need for computer security and to provide people with tips on how to protect their personal information; and it also established seven workgroups for 2017, including authentication, financial services, lead reporting & information sharing, supporting the filing season 2017, tax professional, Strategic Threat Assessment & Response, and Communications subgroups.

44 IRS, Joint Operations Center (JOC), *TPP Snapshot Reports* (FY 2016).

45 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016; report generated Nov. 30, 2016).

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Private sector research shows customers who are subjected to false positives are likely to take their business and go elsewhere ... Unlike customers making a purchase, taxpayers have little choice other than interacting with the IRS. However, taxpayers may be discouraged by the experience of having their returns improperly delayed, increasing the likelihood that they will disengage from their dealings with the IRS in the future.

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information from the “Where’s My Refund” application, he or she will receive a generic message prompting a call to the IRS.

Even if the taxpayer does reach a customer service representative (CSR), he or she will find the CSR does not have access to the EFDS histories and cannot give specific responses to taxpayer inquiries.<sup>46</sup> CSRs take down information and refer it to the IWV group in IVO. IVO, however, does not call back or correspond with a taxpayer based on the referral from a CSR. If the information forwarded by the CSR is not verifiable, IVO will simply close out the referral on an Account Management Services application, without contacting the taxpayer.<sup>47</sup>

Not only can scrutinizing a legitimate return unnecessarily subject taxpayers to a frustrating process, but it may also create a significant financial strain. For example, a delay of more than a month could pose severe consequences for a taxpayer who was relying on the refund to assist with medical expenses, rent, heating, or other necessary living expenses.

### *High FPRs Also Increase Direct and Indirect Costs for the IRS*

High FPRs also come at a cost to the IRS and are a drain on the IRS’s limited resources.<sup>48</sup> Commentators believe that in the private sector false positives cost businesses more than the actual fraud.<sup>49</sup> For example, when a taxpayer’s return is incorrectly identified by one of its fraud detection or identity theft systems, the IRS may have to send letters and notices to the taxpayer, have IRS employees authenticate a taxpayer’s identity at a Taxpayer Assistance Center, or consider taxpayer correspondence. Additionally, when a taxpayer’s issue still cannot be resolved, the taxpayer may decide to come to TAS, incurring yet another downstream cost that could be mitigated by reducing FPRs.<sup>50</sup>

High FPRs not only come with a significant monetary cost, but they also have a detrimental impact on employee engagement. For example, research shows that the second problem with high FPRs is how it

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46 IRM 21.5.6.4.35.3 (Oct. 1, 2016).

47 Integrity and Verification Operation (IVO) does not correspond with a taxpayer based on a referral from a customer service representative. To the contrary, if it is just a refund status inquiry not associated with any verifiable information, IVO employees will just close out the referral on Account Management Services. IRM 25.25.5.2 (July 15, 2016); IRM 25.25.5.4 (Dec. 10, 2015); IRM 25.25.5.4.1 (May 17, 2016).

48 Financial industry experts see a direct correlation between high FPRs and the increased cost of fraud prevention. “As rates rise, fraud prevention requires more labor and becomes more expensive. Indeed, at very high rates, prevention becomes so costly that — from a purely economic view — it could be cheaper simply to let fraud occur.” See Gregg S. Henzel et al., *Using Model Calibration and Optimization to Reduce Fraud Risk: How Financial Institutions Can Identify Fraud More Effectively While Reducing Costs* 3-4 (Crowe Horwath 2015), <https://www.crowehorwath.com/folio-pdf/Using-Model-Calibration-and-Optimization-to-Reduce-Fraud-Risk-Article-RISK-16007-008A.pdf>.

49 See, e.g., Steven Overly, *Artificial Intelligence in Credit Cards Saves You From Faux-Fraud Stupidity*, WASH. POST, A9, Dec. 12, 2016 (“MasterCard estimates that \$118 billion in sales were declined due to falsely identified fraud in the United States in 2014 — well more than the \$9 billion lost to actual instances of fraud.”); SecuredTouch, *Fraud Losses and False Positives: The Numbers* 7 (Dec. 2015), <http://securedtouch.com/fraud-losses-and-false-positives-the-numbers>. (“For example, sales that were blocked by the credit card companies’ fraud detection systems amounted to \$118 billion in 2014, while the cost of real card fraud only amounted to \$9 billion for the same year.”).

50 For FY 2016, TAS received 7,160 cases with TPP issues which had a relief rate of 78.7 percent; 41,819 cases with identity theft issues which had a relief rate of 69 percent; and 29,174 cases with Pre-Refund Wage Verification issues with a relief rate of 80.8 percent. Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2016).

affects the engagement level of those analyzing the company's data for evidence of fraud. Research has shown that when FPRs start to climb above the ratio 25:1, employees know their next alert is unlikely to reveal fraud. Employee incentive to stay engaged lessens and morale erodes. In contrast, when false positives run 5:1, employees know that they are likely to potentially uncover another instance of fraud, thereby encouraging an engaged, focused, and efficient workforce.<sup>51</sup>

In addition to increased costs and eroding employee morale, high FPRs also threaten to negatively impact voluntary compliance. In fact, private sector research shows customers who are subjected to false positives are likely to take their business and go elsewhere. For instance, two-thirds of cardholders who were declined during an e-commerce (electronic) transaction or m-commerce (mobile) transaction reduced or stopped their patronage of the merchant following a false-positive decline, versus 54 percent for all declined cardholders.<sup>52</sup> Unlike customers making a purchase, taxpayers have little choice other than interacting with the IRS. However, taxpayers may be discouraged by the experience of having their returns improperly delayed, increasing the likelihood that they will disengage from their dealings with the IRS in the future. A choice to stop engaging could be met with penalties, but it also means a loss of a compliant taxpayer for the IRS.

## CONCLUSION

The National Taxpayer Advocate recognizes the need to detect and prevent refunds resulting from fraud or identity theft from being issued. However, this objective must be accomplished while respecting and protecting the taxpayer's *right to a fair and just tax system*, meaning the IRS is obligated to design and implement systems that impact as few legitimate taxpayers as possible. Currently, the IRS systems and processes are largely out of step with private industry's accepted fraud and identity theft detection, and prevention systems and processes because real time adjustments to IRS systems are bogged down by established processes. This creates high FPRs, which compromises a taxpayer's *right to be informed*, and *to finality*, and also drains IRS resources, erodes employee morale, while damaging voluntary compliance.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Establish aspirational FPR goals and a schedule to meet them.
2. Continue to build, maintain, and improve private-public partnerships to implement techniques to fight fraud.
3. Establish relationships with other government agencies that use data mining and risk detection systems to learn better techniques for lowering false positive rates.
4. Create a real time governance board to adjust filters and include TAS on this board.

51 Gregg S. Henzel et al., *Using Model Calibration and Optimization to Reduce Fraud Risk: How Financial Institutions Can Identify Fraud More Effectively While Reducing Costs* 3-4 (Crowe Horwath 2015), <https://www.crowehorwath.com/folio-pdf/Using-Model-Calibration-and-Optimization-to-Reduce-Fraud-Risk-Article-RISK-16007-008A.pdf>.

52 Riskified and Javelin, *Overcoming False Positives: Saving the Sale and the Customer Relationship* 4 (Sept. 2015).

**MSP  
#10****TIMING OF REFUNDS: The Speedy Issuance of Tax Refunds Drives Refund Fraud and Identity Theft, As More Research Is Needed on the Costs and Benefits of Holding Refunds Until the End of the Filing Season****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*

**DEFINITION OF PROBLEM**

The IRS processes in excess of 150 million tax returns each year and issues refunds to taxpayers in about 70 percent of the returns received.<sup>2</sup> Although the IRS prides itself in delivering 90 percent of refunds in less than 21 days,<sup>3</sup> many countries deliver tax refunds more quickly than the IRS is able to do. For example, the Organisation for Economic Co-operation and Development (OECD) found that Estonia processed 100 percent of its tax returns with refunds within five working days and Canada delivered 100 percent of its e-filed refunds within 1.6 weeks.<sup>4</sup>

With the average refund amount being nearly \$2,800,<sup>5</sup> delays in processing the refund can cause significant hardship to taxpayers who rely on this refund. The IRS states that this lag time is needed to fully verify the validity of the items reported on the income tax return against the information returns submitted by employers and other third parties. Even with this 21-day delay, the IRS is still susceptible to identity theft and other refund fraud. In a 2015 report issued by the Treasury Inspector General for Tax Administration (TIGTA), TIGTA found that although the IRS's fraud detection efforts were able to stop between \$22 billion and \$24 billion of false refunds from being issued, identity thieves were still able to successfully defraud the government — and taxpayers, collectively — out of approximately \$5.75 billion in the 2013 filing season.<sup>6</sup>

The speed with which a tax agency issues refunds requires the balancing of two compelling interests. That is, there is an inherent tension between the need to get refunds out to taxpayers quickly and the need to protect against refund fraud. Whether the delay should be a couple of weeks, or whether the IRS should not issue refunds until the filing season officially ends, requires careful consideration.

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States-Industry-on-Identity-Theft-Refund-Fraud>.

3 <https://www.irs.gov/Refunds/What-to-Expect-for-Refunds-This-Year>.

4 Organisation for Economic Co-operation and Development (OECD), *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*.

5 <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States-Industry-on-Identity-Theft-Refund-Fraud>.

6 Treasury Inspector General for Tax Administration, Ref. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2* (Apr. 24, 2015).

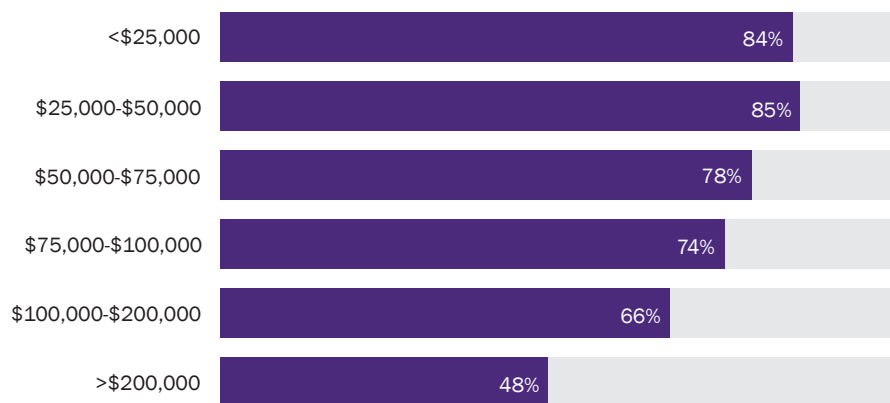


## ANALYSIS OF PROBLEM

Because Congress has chosen to deliver many social benefit programs through the tax system, and because the IRS has done a good enough job of delivering the resulting tax refunds timely, a cultural phenomenon has developed — many U.S. taxpayers now have an expectation that they will receive a sizable refund shortly after the beginning of each tax filing season. The IRS expects more than 70 percent of taxpayers to get a tax refund after they file.<sup>7</sup>

**FIGURE 1.10.1**<sup>8</sup>

### Taxpayers Receiving Refunds by Income Level



**FIGURE 1.10.2, Average Refund Issued by Income Level**<sup>9</sup>

|  | <\$25,000 | \$25,000-\$50,000 | \$50,000-\$75,000 | \$75,000-\$100,000 | \$100,000-\$200,000 | >\$200,000 |
|--|-----------|-------------------|-------------------|--------------------|---------------------|------------|
| Average Refund (of Those Who Got a Refund)   | \$2,056   | \$2,618           | \$2,722           | \$3,246            | \$4,310             | \$15,437   |
| Average Refund/Average Total Positive Income | 16%       | 7%                | 4%                | 4%                 | 3%                  | 4%         |

There are various reasons why one would, in essence, give the government an interest-free loan by choosing to be owed a refund. Some taxpayers have a strong desire to avoid uncertainty or to avoid any chance of underpayment of taxes; others may simply enjoy the psychological benefits of looking forward to getting a large refund each year.<sup>10</sup> One thought is that taxpayers “perceive emotional benefits

<sup>7</sup> <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-Ause-of-IRS-gov-and-e-File-Works-with-States-Industry-on-Identity-Theft-Refund-Fraud>.

<sup>8</sup> Total positive income data from tax year (TY) 2015 Forms 1040 was used to create this chart (data compiled Nov. 10, 2016).

<sup>9</sup> *Id.*

<sup>10</sup> See Donna D. Bobek and Kristin Wentzel, *An Investigation of Why Taxpayers Prefer Refunds: A Theory of Planned Behavior Approach*, JOURNAL OF THE AMERICAN TAXATION ASSOCIATION (Mar. 2008).

(e.g., enjoyment of refund check, reduced anxiety) from over-withholding that equal or offset the financial costs.”<sup>11</sup>

Some taxpayers seem to view the tax system as a “forced savings” mechanism, preferring to overfund their tax withholding to ensure that they receive a lump sum refund when they file their tax return.<sup>12</sup> Researchers have found that as refund timing changes, savings and spending patterns change. In one study, respondents receiving a hypothetical lump-sum tax refund saved more (spent less) than those receiving the same amount, but on a monthly basis.<sup>13</sup>

Other taxpayers receive a significant refund as a result of being eligible for refundable credits, such as the Earned Income Tax Credit (EITC), which are payable only through a lump sum after filing. These taxpayers might not have the opportunity to adjust their withholding enough to eliminate their tax refund.

### **The Protecting Americans from Tax Hikes Act (PATH Act) Will Delay Refunds for Certain Taxpayers Starting in 2016**

Section 201 of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) that was enacted December 18, 2015, requires the IRS to hold all refunds that include EITC or the Additional Child Tax Credit (ACTC) until February 15 for calendar year filers to allow the IRS more time to verify the validity of the refunds and detect fraud. This will delay the issuance of refunds to early filers who have EITC and ACTC claims, causing a significant burden on households that rely on tax refunds to pay bills. Delaying the issuance of the EITC or ACTC until February 15 will significantly impact taxpayers whose refunds represent a significant portion of their yearly income (see Figure 1.10.2, above).

The PATH Act also changes the due date for employers and payors to submit wage information (Form W-2) and non-employee compensation (Form 1099-MISC) to the Social Security Administration. The deadline to file these information returns has been moved up to January 31 from the end of February (if filing on paper) or the end of March (if filing electronically). The new accelerated deadline will make it easier for the IRS to spot errors on returns and verify the legitimacy of tax returns before issuing refunds.

### **States and Foreign Countries Are Combating Refund Fraud by Delaying Refund Issuance or Accelerating Information Reporting**

Some states (including Illinois, Louisiana, and Utah) are beginning to push back the date they issue tax refunds.<sup>14</sup> By delaying the issuance of refunds, these states can enhance their efforts to prevent tax-related refund fraud.

In the United Kingdom, Her Majesty’s Revenue and Customs (HMRC) engaged extensively with employers, software developers, agents, and other interested parties to design a Real Time Information

11 When paid in a lump sum annually, \$243 (81 percent) of the \$300 refund and \$487 (also 81 percent) of \$600 would be saved, vs. \$108 (36 percent) and \$180 (30 percent) saved, respectively, with monthly refunds. See Donna D. Bobek and Kristin Wentzel, An Investigation of Why Taxpayers Prefer Refunds: A Theory of Planned Behavior Approach, *JOURNAL OF THE AMERICAN TAXATION ASSOCIATION* (Mar. 2008).

12 Valerie Chambers & Marilyn Spencer, Does Changing the Timing of a Yearly Individual Tax Refund Change the Amount Spent vs. Saved?, *JOURNAL OF ECONOMIC PSYCHOLOGY* 29 (2008) 856-62.

13 *Id.*

14 See <http://www.dontmesswithtaxes.com/2016/01/state-tax-refunds-to-be-delayed-in-illinois-louisiana-utah-because-of-tax-identity-theft-procedures.html> (last visited Nov. 18, 2016); Ann Carrns, *State Tax Refunds May Be Delayed by Security Precautions*, N.Y. TIMES (Jan. 15, 2016), [http://www.nytimes.com/2016/01/16/your-money/state-tax-refunds-may-be-delayed-by-security-precautions.html?\\_r=0](http://www.nytimes.com/2016/01/16/your-money/state-tax-refunds-may-be-delayed-by-security-precautions.html?_r=0).

reporting of income tax information from employers, starting in 2013.<sup>15</sup> Such an arrangement gives HMRC an early start in examining “Pay-As-You-Earn”<sup>16</sup> income tax information in real time, well ahead of the filing season.

### Do the Benefits of Reducing Improper Payments Outweigh the Costs of Delaying Refunds?

With tax refund fraud becoming a significant problem, costing taxpayers billions of dollars each year, it may make sense for the IRS to delay the issuance of tax refunds while it verifies taxpayer-reported data. If the IRS held off issuing refunds until the end of the filing season, it would have an opportunity to validate return information using Form W-2 data, check for duplicate dependency exemption claims, reconcile child support and alimony reporting, and conduct Automated Underreporter matching, enabling it to process error-free returns and deliver accurate refunds.<sup>17</sup> The IRS should quantify the compliance impact of administering these programs in real time. Once it does, the IRS would be much better positioned to determine whether delaying the issuance of refunds by a couple of months will be justified, after balancing it against the very real financial impact of the delay on taxpayers, particularly low income taxpayers.

Participants in the 2016 IRS Nationwide Tax Forum focus groups cautioned that changing their clients’ mindsets and expectations about the timing of refund delivery would be difficult.<sup>18</sup> Focus group participants reported that taxpayers who claim EITC often depend on their tax refunds for utility bill payments, car repair expenses, property taxes, tuition, and other bills they may have been holding off paying until the tax filing season. With their clients’ urgent need for the refunds, practitioners felt it would take quite a bit of time to change behavior. Thus, in conducting its study of the implications of delayed refunds, the IRS should consider a staged approach, rolled out over several years. In that regard, the February 15 refund date for EITC and ACTC returns will provide the IRS valuable information about the effect of delayed refunds on the most vulnerable taxpayer population.

## CONCLUSION

The OECD reminds us that tax refunds “represent a cost to taxpayers in terms of ‘the time value of money’... Any delays in refunding legitimately overpaid taxes may therefore result in significant ‘costs’ to taxpayers, particularly where there are inadequate provisions in tax laws for the payment of interest to taxpayers with respect to delayed refunds.”<sup>19</sup> Accordingly, the IRS should carefully weigh the cost of delaying the issuance of refunds to taxpayers who may have grown reliant on such refunds being issued a few weeks after tax filing.

15 Her Majesty’s Revenue and Customs, *Real Time Information (RTI): Improving the Operation of Pay As You Earn* (Dec. 17, 2014), [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/388103/RTI-TIIN.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388103/RTI-TIIN.pdf).

16 Under a Pay-As-You-Earn (PAYE) system, such as the one widely used in the United Kingdom, a country collects taxes on items including wages, dividends, and other earnings directly from the payor of that income at the time the income is earned. For more discussion about PAYE systems, see Research Study: *A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems as a Mechanism for Simplifying and Improving U.S. Tax Administration*, vol. 2, *infra*.

17 These procedures, however, raise significant taxpayer rights concerns if not properly administered. See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *supra*, for more detailed discussion.

18 TAS, 2016 IRS Nationwide Tax Forums TAS Focus Group Report: *Timing of Refunds* (Nov. 2016).

19 Organisation for Economic Cooperation and Development (OECD), *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*, [http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/tax-administration-2015\\_tax\\_admin-2015-en#.V8iLK7DVzIU#page1](http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/tax-administration-2015_tax_admin-2015-en#.V8iLK7DVzIU#page1).

**RECOMMENDATION**

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, initiate a research study on the potential savings to the government from reducing improper payments and the potential impact to taxpayers, particularly low income taxpayers, if refund issuance is delayed until after the filing season.

MSP  
#11**PAYMENT CARDS: Payment Cards Are Viable Options for Refund Delivery to the Unbanked and Underbanked, But Security Concerns Need to Be Addressed****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*

**DEFINITION OF PROBLEM**

As the nation's tax administrator, the IRS is responsible for processing approximately 150 million tax returns each year, issuing refunds to taxpayers in about 70 percent of the returns received.<sup>2</sup> According to IRS estimates, it costs more than \$1 per refund check issued compared to only ten cents for each direct deposit made.<sup>3</sup> In addition to the cost savings, the use of direct deposit saves time — taxpayers who use direct deposit should be able to access their refund within one to five days after their return is processed, compared with waiting several weeks for paper checks to arrive in the mail.<sup>4</sup>

Even those without bank accounts can elect to receive their refunds via direct deposit. With over 68 million adults in the U.S. either unbanked<sup>5</sup> or “underbanked,”<sup>6</sup> taxpayers can request that the IRS load their tax refund onto a reloadable debit card, rather than to a conventional bank account.

However, the convenience offered by the IRS delivering refunds via such payment cards (which we will refer to as “prepaid debit cards”) comes at a cost — in the form of refund fraud. Because the IRS receives little information about the owner of the prepaid debit card (compared to a traditional savings or checking account), identity thieves and perpetrators of refund schemes may opt to avoid detection by

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 IRS, *IRS Ready to Start 2016 Tax Season; Encourages Use of IRS.gov and e-File; Works with States, Industry on Identity Theft Refund Fraud*, <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>.
- 3 IRS, *Direct Deposit Your Refund*, [www.irs.gov/individuals/get-your-refund-faster-tell-irs-to-direct-deposit-your-refund-to-one-two-or-three-accounts](http://www.irs.gov/individuals/get-your-refund-faster-tell-irs-to-direct-deposit-your-refund-to-one-two-or-three-accounts) (last visited Sept. 15, 2016).
- 4 IRS, *IRS Ready to Start 2016 Tax Season; Encourages Use of IRS.gov and e-File; Works with States, Industry on Identity Theft Refund Fraud*, <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>; IRS, *2016 Tax Season Refund Frequently Asked Questions*, <https://www.irs.gov/refunds/tax-season-refund-frequently-asked-questions>.
- 5 50.9 million “unbanked” households do not have an account at an insured institution. Federal Deposit Insurance Corporation (FDIC), *2013 FDIC National Survey of Unbanked and Underbanked Households* 4 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.
- 6 16.7 million “underbanked” households have used at least one of the following alternative financial services from non-bank providers in the last 12 months: money orders, check cashing, remittances, payday loans, refund anticipation loans, rent-to-own services, pawn shop loans, or auto title loans. FDIC, *2013 FDIC National Survey of Unbanked and Underbanked Households* 4 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.

requesting refunds via prepaid debit cards. By the time the IRS learns of the refund fraud, the money is already loaded onto prepaid debit cards, leaving the IRS with little chance of recouping those funds.

We will explore the advantages and disadvantages of the IRS issuing tax refunds to taxpayers via prepaid debit cards.

## ANALYSIS OF THE PROBLEM

### The IRS Allows Taxpayers to Load Refunds onto Prepaid Debit Cards

As noted above, a large segment of the U.S. population is unbanked or underbanked. For those without bank accounts, a prepaid debit card is a faster, more secure way to get a tax refund than to request a paper check (which may get lost or stolen). Prepaid debit cards have become disproportionately used by the unbanked and underbanked communities and can be used to pay bills, withdraw cash at ATMs, make purchases, deposit checks, and receive direct deposits. A recent study published by the Federal Deposit Insurance Corporation (FDIC) found that while only eight percent of all households used prepaid debit cards in the last 12 months, unbanked households had the highest rate of use (22.3 percent), compared with underbanked households (13.1 percent) and fully-banked households (5.3 percent).<sup>7</sup>

In 2011, the Department of Treasury conducted a pilot program in which it offered selected taxpayers the option to receive their tax refunds in the form of a government-sponsored debit card.<sup>8</sup> The Urban Institute evaluated the results of the pilot program and found that a government-sponsored debit card could benefit both the government (reducing the cost of delivering refunds) and the taxpayers, making it faster, safer, and more reliable to access tax refunds, as well as providing a way for low and moderate-income taxpayers to access mainstream financial services.<sup>9</sup> The Urban Institute did note one key design flaw that may have impacted the uptake rate — pilot participants were prohibited from using the debit card to pay for tax preparation fees, which likely made this card less attractive to taxpayers who could not afford to pay \$150 to \$400 out of pocket for preparation fees.<sup>10</sup>

The Department of Treasury now requires that all federal benefit payments be delivered electronically, and recommends that those without a bank account use the Direct Express debit card (which is issued by Comerica Bank).<sup>11</sup> For example, the Social Security Administration (SSA) promotes the use of electronic payment to deliver Social Security or Supplemental Security Income benefits. Social Security recipients no longer have the option to request a paper check. For those who do not have an account with a bank or credit union, the SSA offers the Direct Express debit card as a method of accessing benefits.<sup>12</sup>

7 FDIC, *2013 FDIC National Survey of Unbanked and Underbanked Households* 7 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.

8 The Department of Treasury cited low participation rates in the pilot program. Eric Kroh, *Treasury Won't Renew Debit Card Refund Program in 2012, Spokesman Confirms*, TAX NOTES TODAY (Nov. 1, 2011). However, the design of the pilot may have caused the low participation. See National Taxpayer Advocate 2012 Annual Report to Congress 334.

9 Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* (Sept. 5, 2012), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412623-Tax-Time-Account-Direct-Mail-Pilot-Evaluation.PDF>.

10 *Id.*

11 See *Frequently Asked Questions*, <https://fiscal.treasury.gov/godirect/about-faq/> (last visited Oct. 17, 2016).

12 Social Security Administration (SSA), *How Do I Sign Up to Receive an Electronic Payment*, [www.ssa.gov/deposit/howtosign.htm](http://www.ssa.gov/deposit/howtosign.htm) (last visited Sept. 20, 2016).



The IRS allows taxpayers to direct deposit up to three refunds to a single prepaid debit card (unaffiliated with Direct Express), meaning that taxpayers are able to take advantage of the direct deposit program even without a bank account.<sup>13</sup> However, the Treasury-sponsored Direct Express debit card does not accept tax refund payments from the IRS at this time.<sup>14</sup>

The decision to exclude tax refunds from Direct Express cards is perplexing, given that the Earned Income Tax Credit (EITC) is one of the government's largest means-tested anti-poverty programs.<sup>15</sup> If the EITC were administered outside of the tax system, the Department of Treasury would require this federal benefit to be paid electronically, and allow the use of Direct Express cards. With the EITC, however, taxpayers are left to pay for debit cards on the market, with no bargaining power like that which the federal government has for the Direct Express cards. This is an inconsistency that negatively impacts EITC participants.

### The Use of Prepaid Debit Cards Can Be Costly for Both Taxpayers and the IRS

There are some substantial downsides to the use of prepaid debit cards to deliver tax refunds. First is the cost to the taxpayer. Taxpayers can incur numerous fees to enjoy the benefits of using prepaid debit cards. A prepaid debit card can feature an enrollment fee, a monthly maintenance fee, ATM withdrawal fees, ATM balance inquiry fees, and a fee to convert the remaining balance into a bank check, among others. The Consumer Financial Protection Bureau (CFPB) recently issued a rule (effective October 1, 2017) that will help ensure that consumers can make informed decisions when choosing and using prepaid cards and will better protect consumers' funds in prepaid cards in case of errors, loss, or theft.<sup>16</sup> Figure 1.11.1 shows some of the fees charged by several prominent suppliers of prepaid debit cards.

13 IRS, *Direct Deposit Limits*, <https://www.irs.gov/individuals/direct-deposit-limits> (last visited Sept. 20, 2016).

14 See *Frequently Asked Questions*, <https://fiscal.treasury.gov/godirect/about-faq/> (last visited Oct. 17, 2016).

15 Congressional Budget Office (CBO), <https://www.cbo.gov/publication/43935> (last visited Nov. 21, 2016).

16 See Consumer Protection Financial Bureau (CFPB), <http://www.consumerfinance.gov/prepaid-rule/> (last visited Dec. 31, 2016).

**FIGURE 1.11.1, Prepaid Debit Card Fees**<sup>17</sup>

| Prepaid Card Fees                   | Green Dot   | Direct Express   | Mango   |
|-------------------------------------|---|--|---|
| Purchase Price                      | No purchase fee online. Up to \$4.95 in store.  | \$0  | \$0   |
| Monthly Charge                      | Up to \$7.95. Waived in any monthly period when you have loaded at least \$1,000 or have at least 30 qualifying purchases posted to your account. | None   | \$3.00  |
| ATM Fee                             | None at MoneyPass® ATMs nationwide. At non-MoneyPass ATMs, \$2.50, plus any fees the ATM owner may charge.  | One free withdrawal with each Federal Government deposit to your Card Account. Other ATM cash withdrawals \$0.85 each, plus any fees the ATM owner may charge. | \$2.00, plus any fees the ATM owner may charge. |
| Balance Inquiry                     | \$0.50 at non-MoneyPass ATMs  | \$0  | \$1.00  |
| Reload Fee                          | Up to \$4.95  | No information available   | \$0 - your bank may charge a fee                |
| Transfer Funds to U.S. Bank Account | Not allowed   | \$1.50 each time   | No information available                        |
| Teller Cash Withdrawal Fee          | \$2.50  | \$0  | No information available                        |
| Foreign Transaction Fee             | 3%  | 3%   | \$2.00  |
| Foreign ATM                         | No information available  | \$3.00 plus 3% of amount withdrawn   | \$2.00 plus 2% of amount withdrawn              |
| Replacement Card                    | \$4.95  | \$4.00 after one (1) free each year  | No information available                        |
| Customer Service Fee                | No information available  | \$0  | \$0   |

Second, prepaid debit cards can be used to help facilitate refund fraud. According to the Treasury Inspector General for Tax Administration (TIGTA), the government is losing billions of dollars each year to tax refund fraud.<sup>18</sup> With a traditional bank account, the IRS knows the name of the account holder and can order a refund trace from the Bureau of Fiscal Service to verify that a direct deposit went through.<sup>19</sup> The use of prepaid debit cards may be appealing to perpetrators of tax refund fraud since no information other than a bank routing number and account number is required to request that a refund be loaded onto a prepaid debit card.

17 See <https://www.greendot.com/help>; [https://www.usdirectexpress.com/how\\_it\\_works.html](https://www.usdirectexpress.com/how_it_works.html) (the Treasury-recommended Direct Express® card is a prepaid debit card payment option for federal benefit recipients who don't have a bank or credit union account); <https://www.mangomoney.com/simple-fees>. There are 25,000 participating ATMs, including in 2,000 Walmart stores. <https://www.moneypass.com/business-services.html>.

18 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2*, 7 (Apr. 24, 2015).

19 A refund trace is the name of the process used to track a stolen, lost, or misplaced refund check and replace an authorized refund to the taxpayer. A refund trace may also be used to verify a direct deposit. Internal Revenue Manual (IRM) 21.4.2.2 (Oct. 1, 2016).

The IRS is unable to differentiate between a refund that is routed via direct deposit to a bank account and one that is routed to a prepaid debit card.<sup>20</sup> For this reason, the IRS cannot provide a reasonable estimate of how much of the billions lost in refund fraud were paid out via prepaid debit cards. There is anecdotal evidence that identity thieves prefer to use prepaid debit cards, presumably because there is very little useful information provided to the IRS about the owner of the prepaid debit card.<sup>21</sup>

The IRS should add “Direct Express” and “Other Payment Card” as an additional refund type options in the Refund section of each of the Form 1040 series.<sup>22</sup> The IRS should also conduct a pilot, allowing refunds to be direct deposited to taxpayers with existing Direct Express cards, and compare the results with those who use a different prepaid debit card. Using this data, the IRS can be in a better position to analyze whether the use of prepaid debit cards to deliver refunds results in a higher rate of refund fraud, and test various ways the IRS could better validate the identity of the prepaid debit card holder.

### The IRS Should Explore Using Payroll Cards to Deliver Refunds

Payroll cards are a subset of prepaid debit cards. Employers may load money onto payroll cards for employees who do not have bank accounts. Employers can save money by avoiding having to issue paper checks, and employees can get quick, convenient access to their funds.

Six million payroll cards were issued in 2014.<sup>23</sup> By 2019, an estimated 12.2 million workers will receive their wages via payroll cards, compared to only 2.2 million who will get paper checks.<sup>24</sup>

Nineteen states already offer payroll card programs for their employees, as do many retailers in the private workforce, such as Walmart, Home Depot, Macy’s, and McDonalds.<sup>25</sup> The use of payroll cards to deliver tax refunds may be a viable option for the IRS.<sup>26</sup> Because the holder of a payroll card is an employee of a known company, the IRS will have reliable information about the recipient of the tax refund<sup>27</sup> — much more reliable information than it would have for an ordinary prepaid debit card. The IRS could work with the major providers of payroll services to educate employees of participating employers about the ease, convenience, and safeguards of requesting their federal tax refunds be direct deposited onto payroll cards.

20 IRS, Wage & Investment (W&I) response to TAS information request (Sept. 22, 2016).

21 IRS, *IRS’s Top 10 Identity Theft Prosecutions: Criminal Investigation Continues Efforts to Halt Refund Fraud*, IR-2016-45 (Mar. 21, 2016), <https://www.irs.gov/uac/Newsroom/IRSs-Top-10-Identity-Theft-Prosecutions-Criminal-Investigation-Continues-Efforts-to-Halt-Refund-Fraud>.

22 We appreciate that there is no room on the Form 1040 to insert additional lines. However, adding two checkboxes should not lengthen the form.

23 National Consumer Law Center, *Rating State Government Payroll Cards* 5 (Nov. 2015), <https://www.nclc.org/images/pdf/pr-reports/payroll-card-report.pdf>.

24 *Id.*

25 *Id.* at 1, 5.

26 See SOLE Paycard, *5 Reasons to Direct Deposit Your Tax Return onto Your SOLE Visa Payroll Card* (Nov. 18, 2015), [www.solepaycard.com/company/news/direct-deposit-tax-return-sole-visa-payroll-card](http://www.solepaycard.com/company/news/direct-deposit-tax-return-sole-visa-payroll-card).

27 The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) that was enacted Dec. 18, 2015, changes the due date for submitting wage information (Form W-2) and non-employee compensation (Form 1099-MISC) to the Social Security Administration. Starting in 2017, the deadline to file these information returns has been moved up to January 31, enabling the IRS to spot errors on returns and verify the legitimacy of tax returns much earlier in the filing season.

### **The IRS Should Consider How Other Federal and State Agencies Deliver Benefits and Subsidies**

The IRS should consider how other federal and state agencies are delivering payments of benefits and subsidies. Some states give taxpayers the option of receiving state tax refunds on prepaid debit cards issued directly from the state.<sup>28</sup> As administrators of the prepaid debit cards, the states presumably will have more information about the cardholder than if the taxpayer used a third-party debit card.

## **RECOMMENDATIONS**

The National Taxpayer Advocate recommends that the IRS:

1. Participate in a government-sponsored prepaid debit card program (such as Direct Express) offered at no cost to taxpayers.
2. Add “Direct Express” and “Other Payment Card” as additional refund type options in the Refund section of each of the Form 1040 series.
3. Conduct a pilot comparing the refund fraud rate of refunds delivered to the Direct Express card versus non-government-sponsored prepaid debit cards.
4. Work with large employers and major providers of payroll services to conduct a pilot evaluating the efficacy of using payroll cards to deliver federal tax refunds.

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<sup>28</sup> See BankRate.com, *Should Your Tax Refund Go on a Prepaid Card?*, <http://www.bankrate.com/finance/taxes/tax-refund-on-prepaid-card-1.aspx> (last visited Sept. 20, 2016).

MSP  
#12**PRIVATE DEBT COLLECTION (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship****RESPONSIBLE OFFICIALS**

William Wilkins, Chief Counsel

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

In 2006, when the IRS began using private collection agencies (PCAs) to collect delinquent tax debt, the National Taxpayer Advocate identified the practice as a serious threat to taxpayer rights.<sup>2</sup> The private debt collection (PDC) program did not meet IRS expectations or those of Congress, and the IRS discontinued the program in 2009.<sup>3</sup> In 2015, however, Congress enacted legislation that requires the IRS

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 See National Taxpayer Advocate 2006 Annual Report to Congress 34-61, 458-462 (Most Serious Problem: *True Costs and Benefits of Private Debt Collection* and Legislative Recommendation: *Repeal Private Debt Collection Provisions*); National Taxpayer Advocate 2005 Annual Report to Congress 76-93 (Most Serious Problem: *Training of Private Debt Collection Employees*).
- 3 *IRS Conducts Extensive Review, Decides Not to Renew Private Debt Collection Contracts, IRS Employees More Flexible, More Cost Efficient* (Mar. 5, 2009), <https://www.irs.gov/uac/irs-conducts-extensive-review-decides-not-to-renew-private-debt-collection-contracts>; The Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, Div. D, Title I, § 106, 123 Stat. 524, 636 (providing that none of the funds made available in the Act could be used to fund or administer IRC § 6306 debt collection activities by private collection agencies (PCAs)). For a comprehensive analysis of the earlier Private Debt Collection (PDC) program, see National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 97 (Research Study: *The IRS Private Debt Collection Program: A Comparison of Private Sector and IRS Collections While Working the Private Collection Agency Inventory*). See Letter from Nina Olson, National Taxpayer Advocate, to Sen. Ron Wyden, Chairman, Committee on Finance; Sen. Orrin G. Hatch, Ranking Member, Committee on Finance; Rep. Dave Camp, Chairman, Committee on Ways and Means; Rep. Sander Levin, Ranking Member, Committee on Ways and Means; Rep. Charles W. Boustany, Jr., Chairman, Subcommittee on Oversight, Committee on Ways and Means; Rep. John Lewis, Ranking Member, Subcommittee on Oversight, Committee on Ways and Means (May 13, 2014) (National Taxpayer Advocate May 13, 2014 letter to Members of Congress).

to assign certain delinquent tax accounts to PCAs.<sup>4</sup> The IRS plans to begin assigning delinquent taxpayer accounts to PCAs in Spring 2017.<sup>5</sup> The National Taxpayer Advocate believes the IRS, in implementing the congressionally-mandated PDC program, could have achieved a better balance between conserving resources and protecting taxpayer rights. However, she acknowledges that the IRS has been forced to make difficult decisions as it developed procedures for assigning accounts to PCAs.

Over the last year, the National Taxpayer Advocate and her staff have negotiated with the IRS about proposed plans to implement the PDC program in ways that are arguably inconsistent with the law and taxpayer rights. Among other proposals, the IRS has considered:

- Assigning to PCAs the accounts of recipients of Social Security Disability Income (SSDI) benefits, who are subject to income limitations and whose recent returns showed median income of \$14,350;<sup>6</sup>
- Assigning to PCAs the accounts of taxpayers who receive Supplemental Security Income (SSI), which averaged \$539 per month and is not available to taxpayers who have more than \$2,000 in assets; the average household income for recipients of SSI was estimated to be no more than \$684 in May 2013;<sup>7</sup>
- Allowing PCAs to offer taxpayers installment agreements (IAs) that exceed five years — notwithstanding a statutory provision that authorizes PCAs to offer IAs for a period “not to exceed 5 years” — and monitor and receive commissions on payments made pursuant to those IAs;
- Allowing PCAs to solicit “voluntary” payments from taxpayers that do not satisfy the liability in full and are not made pursuant to an IA, despite the absence of any statutory language authorizing PCAs to request voluntary or partial payments;
- Not systemically preventing accounts of taxpayers who currently have a case pending in TAS from being assigned to PCAs; and
- Not recalling accounts assigned to PCAs when the taxpayers request assistance from TAS.

4 Fixing America's Surface Transportation Act, Pub. L. No. 114-94, Div. C, Title XXII, § 32102, 129 Stat. 1312, 1733-36 (2015) (FAST Act).

5 IRS, *Private Debt Collection* (Sept. 26, 2016), [https://www.irs.gov/businesses/small-businesses-self-employed/private-debt-collection?\\_ga=1.43687392.413551195.1473171905](https://www.irs.gov/businesses/small-businesses-self-employed/private-debt-collection?_ga=1.43687392.413551195.1473171905).

6 IRS, Accounts Receivable Dollar Inventory (ARDI), Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), recent returns include those for tax year 2014 or later, data accessed Nov. 28, 2016.

7 Social Security Administration (SSA), Research, Statistics & Policy Analysis, *Monthly Statistical Snapshot, November 2016*, Table 3, [https://www.ssa.gov/policy/docs/quickfacts/stat\\_snapshot/](https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/); SSA, *Social Security, A Guide to Supplemental Security Income (SSI) for Groups and Organizations* 11, 12, 16 (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-11015.pdf>; Government Accountability Office, GAO-16-674, *Supplemental Security Income, SSA Provides Benefits to Multiple Recipient Households but Needs System Changes to Improve Claims Management* 52, Table 10 (Aug. 2016).



While some of the above concerns have been resolved, many have not.<sup>8</sup> Moreover, the IRS's planned implementation of the PDC program unnecessarily burdens taxpayers, particularly those in economic hardship:

- The IRS intends to assign to PCAs the accounts of low income taxpayers who receive Social Security Administration (SSA) or Railroad Retirement Board (RRB) retirement benefits, whose recent returns showed median income of \$19,000;<sup>9</sup> and
- In assigning accounts to PCAs, the IRS does not consider the federal poverty level, which for a single person in 2016 was approximately \$11,880 and 65 percent of the least amount of the IRS's own allowable living expenses (ALEs) for a single person, which the IRS uses to determine, among other things, whether someone is able to provide for basic living expenses; 250 percent of the federal poverty level is approximately \$29,700.<sup>10</sup>

Among the National Taxpayer Advocate's additional concerns:

- PCAs are not required to return to the IRS accounts of taxpayers in economic hardship;
- The IRS does not require transparency of PCAs' calling scripts and training materials;
- The IRS will pay commissions on taxpayer remittances prompted by the initial contact letter from the IRS, rather than PCA action;
- The IRS does not plan to use Referral or Oversight units to facilitate IRS and taxpayer interaction with PCAs and provide oversight of PCAs; and
- Cases the IRS recalls from PCAs will not be worked to completion.

## ANALYSIS OF PROBLEM

### Background

In determining which tasks the IRS may lawfully assign to PCAs, the threshold question is whether the IRS's authority to outsource tax collection is spelled out primarily in Internal Revenue Code (IRC) § 6306 or whether the IRS has broader authority to outsource the collection of federal tax liabilities to PCAs for collection. This question is critical because IRC § 6306 is very specific and narrow in defining which collection activities the IRS may outsource. Therefore, if the IRS does not have broader authority to refer the collection of federal tax liabilities to PCAs for collection, the IRS may contract with PCAs to do only what IRC § 6306 authorizes. If the IRS has broader authority, then it would be necessary to assess the sources of that additional authority.

Both the Bush administration, which proposed the authorities described in IRC § 6306, and the Congress, which enacted the law, believed the IRS did not have the authority to use PCAs — at least in dealing directly with taxpayers.

<sup>8</sup> As discussed below, on December 15, 2016, the IRS agreed to exclude the accounts of Social Security Disability Income (SSDI) and Supplemental Security Income (SSI) recipients from Potentially Collectible Inventory, a statutory term discussed below; and to allow PCAs to receive only one voluntary payment from a taxpayer who cannot pay in full within five years.

<sup>9</sup> IRS, Accounts Receivable Dollar Inventory (ARDI), Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), recent returns include those for tax year 2014 or later, data accessed Nov. 28, 2016, 2016.

<sup>10</sup> U.S. Dept. of Health and Human Resources, *Poverty Guidelines* (Jan. 25, 2016), <https://aspe.hhs.gov/poverty-guidelines>. As discussed below, the least amount of Allowable Living Expenses (ALEs) the IRS would have allowed in 2016 was \$18,396.

In the Administration's fiscal year (FY) 2004 and 2005 Bluebooks, the "Current Law" section of its PDC proposal stated: "Federal tax liabilities generally must be collected by the IRS and cannot be referred to a private collection agency (PCA) for collection."<sup>11</sup>

Similarly, the House-Senate conference committee report accompanying the American Jobs Creation Act stated: "In general, Federal agencies are permitted to enter into contracts with private debt collection companies for collection services to recover indebtedness owed to the United States [citing 31 U.S.C. § 3718, which authorizes agency heads to enter into contracts with PCAs]. That provision does not apply to the collection of debts under the Internal Revenue Code [citing 31 U.S.C. § 3718(f), which excludes from this authorization the collection of debts owed pursuant to the Internal Revenue Code]."<sup>12</sup> Thus, both the Administration and Congress believed IRC § 6306 was required to authorize the use of PCAs to collect Federal tax debts.

In light of the agreed position that the IRS could not use PCAs to collect Federal tax debts without congressional authorization, it follows that the IRS may only use PCAs to collect Federal tax debts to the extent authorized by Congress.

In 2004, Congress enacted IRC § 6306, which authorizes the IRS to enter into "qualified tax collection contracts."<sup>13</sup> The term "qualified tax collection contract" is defined in relevant part as a contract "which is for the services of any person (other than an officer or employee of the Treasury Department)":

- (A) to locate and contact any taxpayer specified by the Secretary,
- (B) to request full payment from such taxpayer of an amount of federal tax specified by the Secretary and, if such request cannot be met by the taxpayer, to offer the taxpayer an installment agreement providing for full payment of such amount during a period *not to exceed 5 years*, and
- (C) to obtain financial information specified by the Secretary with respect to such taxpayer.<sup>14</sup>

In the conference report accompanying the law, Congress described how it expected collection activity pursuant to "qualified collection contracts" would unfold:

Several steps are involved in the deployment of private debt collection companies. First, the private debt collection company contacts the taxpayer by letter. If the taxpayer's last known address is incorrect, the private debt collection company searches for the correct address. Second, the private debt collection company telephones the taxpayer to request full payment. If the taxpayer cannot pay in full immediately, the private debt collection company offers the taxpayer an installment agreement providing for full payment of the taxes over a period of as long as five years. If the taxpayer is unable to pay the outstanding tax liability in full over a five-year period, the private debt collection company obtains financial information from the taxpayer and will provide this information to the IRS for further processing and action by the IRS.<sup>15</sup>

11 Dept. of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* 98 (Feb. 2003); Dept. of the Treasury, *General Explanations of the Administration's Fiscal Year 2005 Revenue Proposals* 151 (Feb. 2004).

12 American Jobs Creation Act, H. REP. NO. 108-755, at 740-41 (2004) (Conf. Rep.).

13 The American Jobs Creation Act of 2004, Pub. L. 108-357, Title VIII, § 881(a)(1), 118 Stat. 1418, 1625-27 (2004) (enacting IRC § 6306).

14 IRC § 6306(b)(1) (emphasis added).

15 H. REP. NO. 108-755, 1782 (2004) (Conf. Rep.).

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**The IRS intends to assign to private collection agencies the accounts of low income taxpayers who receive Social Security Administration (SSA) or Railroad Retirement Board (RRB) retirement benefits, whose recent returns showed median income of \$19,000.**

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At the time this proposal was developed, there was significant discussion about what constitutes an “inherently governmental” function that cannot be outsourced as opposed to a ministerial act that can be contracted out. Under the Federal Activities Inventory Reform Act of 1998, any activity that requires the “exercise of discretion in applying Federal Government authority” is “inherently governmental” and must be performed solely by Federal Government employees.<sup>16</sup> When Congress enacted IRC § 6306 in 2004, the IRS generally did not perform a financial analysis when it accepted full payments or IAs not to exceed five years. In considering IAs longer than five years, collection alternatives such as offers in compromise or partial payment IAs, and requests to place a taxpayer’s account into Currently Not Collectible (CNC)-Hardship status, the IRS generally performed a financial analysis to determine the taxpayer’s ability to pay — an assessment that involved the exercise of discretion. By limiting PCAs to requesting full payments or offering taxpayers IAs providing for full payment during periods not to exceed five years and by requiring PCAs to obtain financial information from taxpayers in all other cases and providing it to the IRS for further processing and action, Congress was careful to authorize PCAs to perform activities that are clear-cut and don’t get into areas where discretion is typically exercised. The statute is unambiguous on its face in describing which activities PCAs are authorized to perform.<sup>17</sup>

In 2015, over the objections of the National Taxpayer Advocate and many others,<sup>18</sup> Congress amended IRC § 6306 to *require* the IRS to enter into “qualified tax collection contracts” with respect to certain “inactive tax receivables.”<sup>19</sup> In doing so, however, it did not make any changes to provisions described above that delineate the boundaries of what PCAs may do. In September 2016, the IRS entered into contracts with four PCAs to implement the PDC program according to procedures contained in the PCA Policy and Procedure Guide (PPG) which, in our view, provides authorization for the PCAs to take actions beyond the scope of what is authorized by IRC § 6306.<sup>20</sup>

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16 Federal Activities Inventory Reform Act of 1998 (FAIR), Pub. L. No. 105-270 § 5(2)(B) 112 Stat. 2382, 2384-2385.

17 In *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984), the Court set out a two-step process for the interpretation of regulations: “When a court reviews an agency’s construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.”

18 National Taxpayer Advocate May 13, 2014 letter to Members of Congress; see e.g., Joe Davidson, *Congress Could Make the IRS Use Private Bill Collectors for Your Taxes*, WASH. POST (Nov. 3, 2015) (describing a letter from 16 U.S. senators to congressional leadership voicing opposition to the proposed PDC program; efforts by 11 representatives to remove the provision from the Fixing America’s Surface Transportation (FAST) Act, and attributing opposition to the provision to the National Treasury Employees Union, the National Council of La Raza, and the National Consumer Law Center); Michael Cohn, *NCCPAP Opposes Plan for IRS Private Debt Collection*, ACCOUNTING TODAY (May 27, 2014) (describing opposition by the National Conference of CPA Practitioners).

19 FAST Act, Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-34, (2015) (adding subsections (c) and (h) to IRC § 6306).

20 IRS, *Private Debt Collection* (Sept. 26, 2016), [https://www.irs.gov/businesses/small-businesses-self-employed/private-debt-collection?\\_ga=1.14327154.413551195.1473171905](https://www.irs.gov/businesses/small-businesses-self-employed/private-debt-collection?_ga=1.14327154.413551195.1473171905). Section III of the IRS’s contract with PCAs, *Performance Work Statement Tax Collection Services*, in § 3.4 provides: “Contractor shall conduct operations in compliance with the most current version of the PPG [PCA Policy and Procedure Guide].” Unless otherwise noted, references to the PPG are to the October 28, 2016 version.

### Certain Aspects of the IRS's PDC Program Are Inconsistent With IRC § 6306

Section ten of the PPG describes three payment options PCAs may pursue in dealing with taxpayers. The first option is to request full payment of the liability (*i.e.*, full payment within 120 days), a course of action clearly authorized by IRC § 6306(b)(1). The second option, however, is available when the taxpayer cannot pay the liability within 120 days but can pay the tax *within the period of limitations on collection* (referred to as the collection statute expiration date or CSED).<sup>21</sup> In that event, the PCA employee can offer the taxpayer an IA for a corresponding number of years.<sup>22</sup> For example, under the current version of the PPG, if the CSED does not expire for eight years, the PCA may offer the taxpayer an eight-year IA. As discussed above, this provision is not authorized by the plain meaning of IRC § 6306(b)(1).

A third option is available when the taxpayer cannot pay the tax within 120 days or within the CSED. In that event, the current version of the PPG states the PCA employee will solicit “voluntary payments.”<sup>23</sup> This means the PCA, without offering an IA or securing any financial information for analysis by the IRS, may periodically contact the taxpayer and secure payments that do not resolve the account. This solicitation, and resulting partial payments, may continue indefinitely, as interest continues to accrue on the unpaid liability.<sup>24</sup> This practice of soliciting voluntary payments is a significant departure from the manner in which the IRS Collection function proceeds, described below, and violates taxpayers’ rights.<sup>25</sup> Moreover, as discussed below, it also goes beyond the statutory authority conferred by IRC § 6306.

Additionally, neither the current PCA contract nor the PPG authorizes PCAs to collect financial information from taxpayers, one of the required components of a “qualified tax collection contract.” Thus, it is arguable that the IRS’s contracts with PCAs do not constitute “qualified tax collection contracts” within the meaning of IRC § 6306(b)(1) because they do not contain one of the three statutorily specified components of such contracts.<sup>26</sup>

21 The IRS must generally collect tax within ten years after assessment. See IRC § 6502.

22 PCA Policy and Procedures Guide (PPG) § 11, *PCA Payment Arrangements*. The PCA can offer IAs only where the amount of the assessed tax, penalties, and interest does not exceed \$100,000.

23 In contrast, PPG § 10.2.1, *Voluntary Payments*; PPG § 10.2.2, *Alternative Collection Resolution* provides that the PCA employee “should” inform the taxpayer that alternative collection resolutions (e.g., offer in compromise) are available through the IRS at [irs.gov](http://irs.gov).

24 As discussed below, many taxpayers whose accounts will be assigned to PCAs are already in economic hardship and may agree to make payments they cannot afford. See vol. 2 Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*; vol. 2 Research Study: *IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies*.

25 It is also a departure from procedures used in the prior PDC program. PPG § 11.9, *IA Beyond PCA Authority* (2008 version), included among arrangements the PCAs did not have authority to make: “Proposed IA [installment agreement] is for a time period beyond 60 months” and “IA will not result in full payment prior to the expiration of the CSED.” PPG § 11.9.3, (2008 version) provided: “Note: When an IA covering more than 60 months or an IA not providing for full payment by the CSED is accepted by the IRS, the case will be recalled by the IRS.”

26 In contrast, PPG § 11.9.1 *Collection Information Statement* (2008 version), provided: “[t]he PCA employee must attempt to secure financial information for an IA [installment agreement] with any of the following: ...The amount the taxpayer offers to pay will not pay the sum of the aggregate assessed balance due for each tax period within 60 months” or “IA will not result in full payment prior to the expiration of the CSED.”

*Allowing PCAs to Solicit “Voluntary” Payments That Do Not Resolve the Liability Violates Taxpayers’ Rights and Is Not Authorized by Statute*

Taxpayers who are able to full-pay their liabilities in either a lump-sum or an IA of up to six years ordinarily may do so without providing financial information that must be analyzed by an IRS Collection employee.<sup>27</sup> By contrast, an IRS Collection employee generally must become involved where a taxpayer cannot full-pay within that period. For example, if a taxpayer cannot pay any amount, can pay some amount less than the full liability over the CSED, or can full-pay the liability over a period longer than six or seven years, an IRS employee must determine whether the taxpayer should be placed into CNC-Hardship status<sup>28</sup> or approved for an offer-in-compromise,<sup>29</sup> a partial-payment IA,<sup>30</sup> or a non-streamlined IA.<sup>31</sup> The appropriate resolution is made on the basis of the taxpayer’s financial information, and IRS Collection employees exercise discretion in arriving at the appropriate resolution. These IRS procedures support taxpayers’ *right to a fair and just tax system* by considering facts and circumstances that might affect their ability to pay.

IRS Collection employees are generally *not* free to simply solicit payments from a taxpayer other than as part of an overall plan to fully resolve the liability.<sup>32</sup> Rather, they are expected to support a taxpayer’s *right to finality* by fully resolving the account. Taxpayers whose accounts are assigned to PCAs might well qualify for CNC-Hardship status or other collection alternatives, but PCAs have no incentive to provide details about collection alternatives and, despite a clear statutory requirement, the PPG makes no provision for the PCAs to collect financial information that might help taxpayers qualify for those alternatives.<sup>33</sup>

27 IRS, *Streamlined Processing of Installment Agreements* (Nov. 10, 2016), [https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements?\\_ga=1.48328931.413551195.1473171905](https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements?_ga=1.48328931.413551195.1473171905). Approval of full-pay IAs of up to six years is generally automatic when the tax liability does not exceed \$50,000, and taxpayers may enter into them online without speaking with an IRS employee or providing their financial information. The IRS is testing streamlined processing for tax liabilities that do not exceed \$100,000 and can be full paid within seven years. Taxpayers seeking any IA must be current with their filing obligations. Internal Revenue Manual (IRM) 5.14.1.4.2, *Compliance and Installment Agreements* (Sept. 19, 2014).

28 See IRM 5.16.1.1, *Currently Not Collectible Overview* (Aug. 25, 2014); IRM 5.16.1.2.9, *Hardship* (Aug. 25, 2014). IRM 5.15.1.16, *Making the Collection Decision* (Nov. 17, 2014), (including among acceptable collection decisions the designation of accounts as CNC due to economic hardship).

29 See IRC § 7122; Treas. § Reg. 301.7122-1(b)(2), authorizing compromises where there is doubt as to collectability, which “exists in any case where the taxpayer’s assets and income are less than the full amount of the liability.”

30 See IRM 5.14.2.1, *Overview* (Mar. 11, 2011)(explaining that “[i]f full payment cannot be achieved by the Collection Statute Expiration Date (CSED), and taxpayers have some ability to pay, the Service can enter into Partial Payment Installment Agreements (PPIAs).”

31 See IRM 5.14.1.4, *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014).

32 For example, IRM 5.1.10.3.2 *Effective Initial Contact* (Feb. 26, 2016), in paragraph (7), provides: “If the case is not resolved during the initial contact, discuss a realistic plan for case resolution with the taxpayer, establish and document a plan for resolving the case, such as: full pay (FP) by a specified date, installment agreement (IA), etc. This plan may be updated when it changes. For example, a plan to resolve a case as CNC (hardship) may change to FP when significant assets and/or income are discovered.” Similarly, IRM 5.14.1.4, *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014) directs “If taxpayers do not qualify for Guaranteed, Streamlined or In-business Trust Fund Express installment agreements, determine a plan for resolving the balance due accounts based on the Collection Information Statement (CIS) and supporting documentation provided by the taxpayer (See IRM 5.1.10.3.2 and IRM 5.15). Note: In determining the most appropriate plan for resolving the balance due, consider actions that are least intrusive to the taxpayer and meets the need of the government for efficient collection of the tax, including viable payment options provided in IRM 5.14.1.4.1 or 5.14.2 to ensure the rights of the taxpayers are protected, IRM 5.1.10.7.1.3.”

33 As noted above, the PDC program actually violates eight of the ten taxpayer rights contained in the Taxpayer Bill of Rights.

*Congress Did Not Intend to Allow PCAs to Solicit “Voluntary” Payments That Do Not Full Pay the Liability and Are Not Made Pursuant to an Installment Agreement (IA)*

Under the Federal Activities Inventory Reform Act of 1998 (FAIR Act), any activity that requires the “exercise of discretion in applying Federal Government authority” is “inherently governmental” and must be performed solely by Federal Government employees.<sup>34</sup> As discussed above, Congress designed the PDC program in a manner that authorized PCAs to perform only limited activities that do not involve the exercise of discretion. For example, to avoid placing PCAs in the position of working with taxpayers whose cases require financial analysis, and thus involve the exercise of discretion, Congress authorized the PCAs only to request full payment or IAs not to exceed five years, and, if the taxpayer says he or she cannot pay the liability in full within five years, to collect financial information from the taxpayer to be forwarded to the IRS for analysis.

*The IRS’s Explanation of Why Questioned Procedures Are Permissible Is Unconvincing*

TAS requested clarification from IRS Office of Chief Counsel about the apparent departures from the way Congress intended PCAs to proceed. Counsel confirmed that IRC § 6306 does not allow PCAs to offer IAs exceeding five years but stated:<sup>35</sup>

The contract may, however, provide that, with IRS approval of a taxpayer’s request for an installment agreement of longer than five years, the PCA can retain the account to monitor compliance with the agreement for its entire term. The IRS and PCA may agree on compensation for the performance of these functions, whether as commission on each payment or on some other basis. Nothing in section 6306 would preclude such an arrangement.<sup>36</sup>

Thus, according to IRS Chief Counsel, by “retaining” an account, a PCA may monitor payments made pursuant to an IA that could only have been organized and entered into by the IRS (or possibly, as discussed below, with assistance from TAS) and receive commissions on those payments.

As for soliciting “voluntary” payments as described above, IRS Chief Counsel notes simply that “there is nothing prohibiting the Service from authorizing a private debt collector to make such a solicitation.”<sup>37</sup> Accordingly, the current version of the PPG allows for both monitoring of IAs in excess of five years and acceptance of repeated voluntary payments from taxpayers who cannot pay within five years.

Counsel’s interpretation strikes us as a results-oriented end-run around the statute. The IRS has made clear that it is facing extraordinary resource constraints, that it would like the PCAs to do more without requiring IRS involvement, and that it is not asking the PCAs to collect financial information because it does not have the resources to review any such financial information. While we sympathize with the IRS’s position, resource constraints do not justify misapplying an act of Congress. If the PCAs do not collect

34 Pub. L. No. 105-270, § 5(2)(B) 112 Stat. 2382, 2384-2385 (1998) (providing that the term “inherently governmental function” means a function that is so intimately related to the public interest as to require performance by Federal Government employees.” The term includes “activities that require either the exercise of discretion in applying Federal Government authority or the making of value judgments in making decisions for the Federal Government, including judgments relating to monetary transactions and entitlements. An inherently governmental function involves, among other things, the interpretation and execution of the laws of the United States so as (i) to bind the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise; ... (iii) to significantly affect the life, liberty, or property of private persons.”

35 IRS Chief Counsel response to TAS information request (Nov. 17, 2016).

36 *Id.*

37 *Id.*



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Counsel's interpretation strikes us as a results-oriented end-run around the statute. The IRS has made clear that it is facing extraordinary resource constraints, that it would like the private collection agencies (PCAs) to do more without requiring IRS involvement, and that it is not asking the PCAs to collect financial information because it does not have the resources to review any such financial information. While we sympathize with the IRS's position, resource constraints do not justify misapplying an act of Congress.

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financial information, any IRS "approval" (to use Counsel's word) of an IA exceeding five years is simply a *pro forma* rubber stamp of a PCA request to offer a taxpayer a longer-term IA — which effectively ignores the statutory language that an IA offered by a PCA must be limited to a period "not to exceed five years."

Allowing PCAs to accept an unlimited number of "voluntary payments" would also constitute an end-run around the statute. The reputation of PCAs for hounding debtors is well documented, including through vast numbers of complaints to the Federal Trade Commission. By restricting PCAs to accepting lump-sum full payments or full payment IAs not to exceed five years, Congress limited the risk that U.S. taxpayers would be subject to endless calls. If a taxpayer agrees to the authorized payment terms, there will be no more calls. If the taxpayer says he or she cannot comply those payment terms, the statute and legislative history together make clear the PCA should take financial information and then forward the information to the IRS, so again there should be no more calls.

But if the IRS now allows PCAs to call taxpayers repeatedly to request partial "voluntary payments," the PCAs may be hounding taxpayers in a manner that Congress did not see fit to authorize. Moreover, the taxpayer will not have the benefit of closure, as he or she would have when dealing with an IRS employee, because an IRS employee can conduct a financial analysis and offer to compromise the debt or place it into uncollectible status if the facts warrant. This would undermine the taxpayer's *right to finality*.<sup>38</sup>

On December 15, 2016, and again on December 21, 2016, the National Taxpayer Advocate met with the Commissioner of Internal Revenue and other IRS officials, raising her concerns about the appropriateness of these procedures. As a result of these meetings, the Commissioner agreed that PCAs may accept one voluntary payment if the taxpayer says he or she cannot pay in full or within five years, but offers to make a one-time payment toward the debt. The National Taxpayer Advocate applauds the Commissioner's decision, and she and her staff will work with the IRS to ensure the PPG is revised accordingly.

However, the Commissioner agreed with the IRS that PCAs may "monitor" payments where the taxpayer has been referred back to the IRS for acceptance of a six- or seven-year IA (partially consistent with IRS

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38 These concerns are not merely theoretical. In studies included in Volume 2 herein, the National Taxpayer Advocate shows that almost 40 percent of taxpayers entering into an IA in 2014 agreed to make installment payments even though their Allowable Living Expenses exceeded their Total Positive Income, and the IRS could and should have systemically excluded a significant percentage of these taxpayers as CNC-hardship. See Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*; Research Study: *IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies*, vol. 2, *infra*.

internal policies for streamlined IAs, which were recently extended from five to six years)<sup>39</sup> and receive 25 percent of all such payments, notwithstanding that it was the IRS itself that placed the taxpayer into an IA.

The National Taxpayer Advocate remains concerned with the “monitoring” of accounts where a taxpayer has entered into an IA that exceeds five years. Where a PCA locates and contacts a taxpayer, but does not enter into an IA, the PCA should be paid a fee for those location and contact services. Under the statute, if the PCA enters into an IA, then the PCA is entitled to receive compensation up to 25 percent of the amounts collected. But there is no statutory authorization for the PCA to receive compensation for tasks performed for IAs exceeding five years in length. If the taxpayer defaults on such a contract, the ensuing contacts and resolution of the taxpayer’s case are far more likely to involve acts that require the exercise of judgment and discretion and therefore cannot be handled by the PCAs.

Moreover, paying PCAs a 25 percent commission for work that was or will need to be accomplished by the IRS constitutes a windfall to the PCAs. It also creates an incentive for the IRS to push taxpayers into six year IAs rather than longer IAs that may be more appropriate for the taxpayer’s specific situation, simply because the IRS itself will retain an additional 25 percent of the collections (in addition to the appropriations and user fees the IRS receives). In that case, not only the debtor taxpayer is harmed, but all taxpayers are harmed because fewer tax dollars are going to the public fisc.

Moreover, a TAS study included in Volume Two of this Report demonstrates that failure to conduct a financial analysis of taxpayers with delinquent accounts can erode current and future tax compliance:

- Many taxpayers initiate IAs even though their incomes are less than their ALEs, meaning that taxpayers are likely forgoing necessities to meet the terms of their IAs;
- Taxpayers are more likely to default on their IAs when their incomes are below their ALEs, suggesting that these taxpayers are entering into IAs they cannot afford;
- Taxpayers become more likely to be noncompliant in the years after they start an IA, suggesting that the terms of IAs are not necessarily realistic from the standpoint of a taxpayer’s ability to pay; and
- The involvement of TAS in IAs increases subsequent payment compliance and decreases the likelihood that taxpayers will default on their IAs. This fact suggests that additional financial analysis will increase the number of successful IAs and reduce subsequent noncompliance.<sup>40</sup>

For all these reasons, the National Taxpayer Advocate recommends that the IRS revise the PCA contract to allow PCAs to monitor only IAs not exceeding five years and further provide for a fee schedule for locating and contacting taxpayers for cases where the taxpayer cannot full pay or enter into an IA up to five years. This approach will ensure PCAs get paid for all work they perform but also protect the public fisc, and it is consistent with the limited statutory authority provided by IRC § 6306.

39 See IRM 5.14.5.2 *Streamlined Installment Agreements* (Dec. 23, 2015). The IRS is currently conducting a pilot under which taxpayers may enter into installment agreements of up to seven years without the need for a financial analysis. For details, see <https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements>.

40 See Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*.

### The IRS's Planned Implementation of the Private Debt Collection (PDC) Program Unnecessarily Burdens Taxpayers, Particularly Those in Economic Hardship

As discussed above, IRC § 6306(c) generally requires the IRS to assign to PCAs all “inactive tax receivables,” described as any “tax receivable” that meets any one of three criteria.<sup>41</sup> A “tax receivable” for purposes of the statute is an account the IRS includes in its “potentially collectible inventory” (PCI).<sup>42</sup> Potentially collectible inventory is an undefined term — that is, no provision of the IRC, the Treasury Regulations, or the Internal Revenue Manual (IRM) provides a definition of PCI. However, the Office of Chief Counsel has advised the National Taxpayer Advocate that PCI does not include accounts designated as CNC due to the economic hardship of the taxpayer.<sup>43</sup>

The IRS is required by statute and by Treasury regulation to take certain actions when it knows taxpayers are experiencing economic hardship. IRC § 6343 requires the IRS to release a levy when it “has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer.”<sup>44</sup> Economic hardship “exists when a levy will cause an individual to be unable to pay his or her reasonable living expenses.”<sup>45</sup> In the *Vinatieri* case, the U.S. Tax Court held that when the IRS sustains even a proposed levy on a taxpayer it knows is in economic hardship, it abuses its discretion.<sup>46</sup> In light of the *Vinatieri* case, the IRS adopted procedures that require its employees to consider, before proceeding with a levy, whether the levy would create economic hardship for the taxpayer.<sup>47</sup> The same concerns apply with respect to PCAs — it is inappropriate to assign cases for collection knowing there is a great risk of economic hardship if collection — even voluntary payments — proceeds. The IRS should not be placing taxpayers at risk of not being able to meet their basic living expenses in order pay their taxes.

The IRS generally designates an account as CNC hardship after considering financial information the taxpayer provides and taking into account expenses the IRS would routinely allow — namely, ALEs.<sup>48</sup> Accounts that do not actually bear the CNC hardship designation, however, are not exempt from assignment to PCAs even though the taxpayer may be in economic hardship.<sup>49</sup>

41 IRC § 6306(c)(2)(A) provides that “[t]he term ‘inactive tax receivable’ means any tax receivable if (i) at any time after assessment, the Internal Revenue Service removes such receivable from the active inventory for lack of resources or inability to locate the taxpayer, (ii) more than 1/3 of the period of the applicable statute of limitation has lapsed and such receivable has not been assigned for collection to any employee of the Internal Revenue Service, or (iii) in the case of a receivable which has been assigned for collection, more than 365 days have passed without interaction with the taxpayer or a third party for purposes of furthering the collection of such receivable.”

42 IRC § 6306(c)(2)(B).

43 IRS response to TAS fact check (Dec. 13, 2016). A number of conditions may cause the IRS to designate an account as currently not collectible (CNC), such as the inability to locate or contact the taxpayer, where the statutory period for collecting the tax has expired, where the amount owed is below tolerance levels, or where the taxpayer is in economic hardship. See IRM 5.16.1.2, *Currently Not Collectible Procedures* (Jan. 1, 2016). In addition, some tax receivables are statutorily excluded from eligibility for assignment to PCAs. IRC § 6306(d) provides that a tax receivable is not eligible for assignment to a PCA if it “(1) is subject to a pending or active offer-in-compromise or installment agreement, (2) is classified as an innocent spouse case, (3) involves a taxpayer identified by the Secretary as being (A) deceased, (B) under the age of 18, (C) in a designated combat zone, or (D) a victim of tax-related identity theft, (4) is currently under examination, litigation, criminal investigation, or levy, or (5) is currently subject to a proper exercise of a right of appeal under this title.”

44 IRC § 6343(a)(1)(D).

45 Treas. Reg. § 301.6343-1(b)(4).

46 *Vinatieri v. Comm’r*, 133 T.C. 392 (2009).

47 See IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014) which provides that when determining if a levy is appropriate, revenue officers are to consider “the taxpayer’s financial condition, including information discussed in IRM 5.1.12.20.1.1 related to economic hardship determinations,” and noting that “if the Revenue Officer can verify from the information available that the levy will cause an economic hardship, the levy will not be issued, because if there is economic hardship, the levy must be released under IRC 6343(a)(1)(D).”

48 See IRM 5.16.1.2.9, *Hardship* (Aug. 25, 2014).

49 Letter from Scott Prentky, Director, Collection to Chi Chi Wu, Staff Attorney, National Consumer Law Center (Sept. 12, 2016).

TAS Research identified almost 380,000 taxpayer accounts the IRS intends to assign to PCAs in the first phase of assignments scheduled for 2017.<sup>50</sup> Of these taxpayers, more than 273,000 filed a recent tax return:<sup>51</sup>

- Median income shown on the returns was about \$32,000;<sup>52</sup> and
- More than a third of the returns showed income of less than \$20,000.<sup>53</sup>

The *least* amount of ALEs the IRS would have allowed in 2016 was approximately \$18,000 for a single person. Thus, the expenses of some of these taxpayers actually exceeded their incomes, even assuming a single person household.<sup>54</sup> A TAS study included in this report found that almost 40 percent of taxpayers entering into IAs in 2014 agreed to make installment payments even though their ALEs exceeded their Total Positive Income (TPI).<sup>55</sup>

*The IRS Interprets the 2015 Legislation As Requiring It to Assign Accounts the IRS Itself Has Made a Policy Decision to Not Collect Because There Is a Great Risk of Causing Economic Hardship*

Because the phrase “potentially collectible inventory” is not defined by statute or Treasury regulation and is not explained in the IRM or other IRS guidance, the National Taxpayer Advocate believes Congress intended to provide the IRS with some administrative flexibility in its definition of PCI. Thus, the National Taxpayer Advocate urged the IRS to exclude from its definition of “potentially collectible inventory” some accounts that the IRS itself does not subject to certain levies on the ground that these taxpayers would likely experience economic hardship.

*The IRS Adopted a Proxy for Economic Hardship for Purposes of the Federal Payment Levy Program (FPLP)*

IRC § 6331(h) authorizes the IRS to impose continuing levies on certain federal payments, including SSA and RRB retirement benefits, and the FPLP is the IRS’s automated program that carries out these levies.<sup>56</sup>

50 There are 379,576 such accounts. IRS ARDI, CDW, data accessed Nov. 28, 2016. The IRS is in the process of identifying additional accounts eligible for assignment in 2017. IRS response to TAS information request (Nov. 18, 2016).

51 IRS ARDI, IRTF, CDW, data accessed Nov. 28, 2016, showing there were 273,105 such taxpayers. Recent returns include those for tax year 2014 or later. Not all taxpayers whose accounts are included in potentially collectible inventory had a 2015 filing requirement. See, e.g., IRC § 1; IRS Publication 501, *Exemptions, Standard Deduction, and Filing Information 2* (2015). For example, a single person under age 65 at the end of 2015 was not required to file a 2015 return unless his or her gross income was \$10,300 or more.

52 IRS ARDI, IRTF, CDW, data accessed Nov. 28, 2016, showing that median income reported on these returns was \$31,842.

53 *Id.*, showing that 38 percent of these returns reported income of less than \$20,000.

54 The lowest amount allowed for monthly housing and utilities in 2016 for a taxpayer under 65 was \$736, which is the amount allowed for taxpayers who live in Wade Hampton, AK. The lowest amount of monthly operating costs for one vehicle (not including ownership costs) was \$173, the amount allowed for taxpayers who live in Seattle, WA. The national standard for monthly food and clothing was \$570 and for health care it was \$54. Thus, the least amount of monthly ALE for a hypothetical taxpayer who was under 65, lived in Wade Hampton, AK but used the vehicle operating cost for Seattle, WA was \$1,533. Total annual expenses for this hypothetical taxpayer would be \$1,533 X 12 = \$18,396. IRS ALE (Mar. 28, 2016), <http://mysbse.web.irs.gov/Collection/toolsprocesses/AllowExp/Standards/default.aspx>.

55 See Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*.

56 See IRM 5.11.7.2, *Federal Payment Levy Program* (Sept. 23, 2016).

The IRS generally does not subject SSA and RRB payments to FPLP levies when the recipient's income is less than 250 percent of the federal poverty level, a measure that serves as a proxy for economic hardship.<sup>57</sup>

Of the almost 380,000 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017:

- About 39,000 — or 10 percent — were recipients of SSA or RRB benefits in 2015;<sup>58</sup>
- The recent returns of these 39,000 SSA or RRB recipients showed median income of about \$19,000;<sup>59</sup>
- Of these 39,000 taxpayers, 14,300 filed recent returns showing income equal to or less than 250 percent of the federal poverty level.<sup>60</sup> The IRS would therefore generally not impose FPLP levies on these taxpayers' SSA or RRB benefits, yet it considers their accounts eligible for assignment to PCAs;
  - The median income of these 14,300 taxpayers was about \$9,700;<sup>61</sup> and
  - 9,000 of the 14,300 taxpayers (or 63 percent) were actually living at or below the poverty level.<sup>62</sup>

### *The IRS Excludes Social Security Disability Income Payments from FPLP Levies, Yet Recipients' Accounts May Be Assigned to PCAs*

The IRS refrains from imposing FPLP levies on federal benefits paid to recipients of SSDI (without considering ALEs or applying a proxy for economic hardship).<sup>63</sup> In order to receive SSDI, taxpayers generally cannot earn over \$1,130 per month.<sup>64</sup> Of the almost 380,000 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017:

- About 11,000 — or three percent — were SSDI recipients in 2015.<sup>65</sup> The IRS would not impose FPLP levies on these taxpayers' SSDI benefits, yet it considers their accounts eligible for assignment to PCAs; and
- The median income shown on the recent returns filed by these taxpayers was \$14,350.<sup>66</sup>

57 IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (June 23, 2014). For a description of the TAS model to estimate the income and expenses of taxpayers whose SSA, RRB, and SSDI income had been subject to Federal Payment Levy Program (FPLP) levies, which led to the adoption of the 250 percent proxy for economic hardship, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

58 IRS, ARDI, IRTF, IRMF, CDW, data accessed Nov. 28, 2016, showing that of the 379,576 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017, 38,619 received SSA benefits. TAS designed syntax to identify delinquencies being sent to the private debt collection companies based on information provided by the IRS; however, the IRS could neither verify or disprove the results.

59 *Id.*, showing that the median income shown on returns filed by these taxpayers was \$18,984.

60 *Id.*, showing 14,265 taxpayers filed returns for tax year 2014 or later.

61 *Id.*, showing that median income for these 14,265 taxpayers was \$9,727.

62 Because incomes were estimated using the most recent total positive income of tax years 2014 and 2015, the federal poverty level for the corresponding year was used to determine whether taxpayers were below the federal poverty level. *Id.*, showing that of the 14,265 taxpayers, 8,999 were living at or below the poverty level.

63 SB/SE-05-1015-0067, *Federal Payment Levy Program - Exclude SSA Disability Insurance Payments* (Oct. 7, 2015).

64 See SSA, *Update 2016* (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-10003.pdf>.

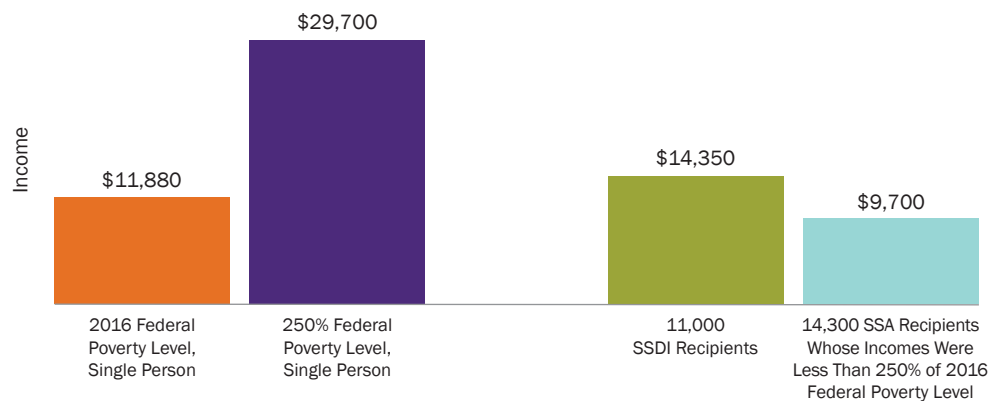
65 IRS, ARDI, IRTF, IRMF, CDW, data accessed Nov. 28, 2016, showing that of the 379,576 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017, 10,947 received SSDI benefits.

66 *Id.*, showing that of the 10,947 taxpayers who received SSDI benefits in 2015, 5,345 filed tax returns in 2014 or 2015. The median income shown on these returns was \$14,350.

This data is shown in Figure 1.12.1. Once these accounts are assigned to PCAs, these taxpayers may agree to make payments they cannot afford, which may mean they will not have sufficient funds left to pay for basic living expenses such as rent, utilities, food, medication, or medical treatment.<sup>67</sup>

**FIGURE 1.12.1**

**Median Income Shown on Returns of Taxpayers Whose Accounts the IRS Would Not Itself Collect Through Federal Payment Levy Program (FPLP) Levies But Intends to Assign to PCAs in 2017, Compared to 2016 Federal Poverty Level**



*The IRS Excludes Supplemental Security Income (SSI) Payments from FPLP Levies and Is Statutorily Prohibited From Imposing Non-FPLP Levies on SSI Payments, Yet Recipients' Accounts May Be Assigned to PCAs*

Elderly, blind, or disabled persons may receive SSI. In order to receive SSI in 2016, a single person could not have:

- Earned income of more than \$1,551 per month;
- Unearned income of more than \$753 per month; or
- Assets worth more than \$2,000.<sup>68</sup>

67 The 2008 TAS study also found that more than one-quarter of FPLP taxpayers who paid their tax liability, entered into an IA with the IRS, or were subject to an ongoing FPLP levy had incomes at or below the federal poverty level. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48, 49 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

68 SSA, *Social Security, A Guide to Supplemental Security Income (SSI) for Groups and Organizations* 11, 12, 16 (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-11015.pdf>.



The highest federal SSI payment to a single person in 2016 was \$733 per month.<sup>69</sup> The average SSI payment was \$539 in November of 2016.<sup>70</sup> The average household income for recipients of SSI was estimated to be no more than \$684 in May of 2013.<sup>71</sup> For these reasons, the IRS itself refrains from subjecting SSI benefits to FPLP levies and is prohibited by law from subjecting SSI payments to non-FPLP levies.<sup>72</sup> Of the taxpayers whose accounts the IRS intends to assign to PCAs, some are undoubtedly recipients of SSI, although systemic limitations have made it difficult to identify the number.<sup>73</sup>

On December 15, 2016, the National Taxpayer Advocate met with the Commissioner of Internal Revenue and other senior IRS leaders to discuss the exclusion of these three taxpayer categories. The National Taxpayer Advocate reasoned that because the IRS had already made a determination under the FPLP that collecting from these taxpayers would create an economic hardship, it is very likely that these taxpayers are not collectible. However, all of these populations — the low income, elderly, and the disabled — are disproportionately vulnerable to pressure, as is evidenced by many of them falling victims to tax and other types of scams.<sup>74</sup> Moreover, TAS research studies reported in this Annual Report show that taxpayers agree to pay IRS debts even where they cannot afford to pay their basic living expenses, perhaps largely out of fear.<sup>75</sup> Thus *any collection contacts* with respect to taxpayers in these population groups place their health and welfare at risk.

Commendably, the IRS Commissioner agreed that SSDI and SSI taxpayers should be excluded from the PCA population because of the high risk that they would experience economic hardship. Because of the IRS's prior refusal to exclude these taxpayers, however, IRS personnel say this decision came too late in the process to implement the necessary programming to exclude these taxpayers. Thus, the IRS is saying that a portion of almost 11,000 SSDI taxpayers and an unknown number of SSI taxpayers will be included in at least the first batch of PCA cases. This unfortunate situation will continue unless and until the IRS completes the required programming to exclude these taxpayers, creating a substantial risk of harm.

The National Taxpayer Advocate was not successful in convincing the IRS Commissioner to exclude the accounts of taxpayers who receive Social Security retirement benefits and have income at or below 250

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- 69 SSA, *Social Security, A Guide to Supplemental Security Income (SSI) for Groups and Organizations* 7 (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-11015.pdf>. As the guide notes, some states provide supplemental benefits and “[i]f Social Security runs the state’s supplemental payment, one check is paid to the beneficiary each month that combines the federal and state SSI benefits. States may change the payment amounts based on where, and with whom, people live. Also, some states might not count other income.”
- 70 SSA, Research, Statistics & Policy Analysis, *Monthly Statistical Snapshot, November 2016*, Table 3, [https://www.ssa.gov/policy/docs/quickfacts/stat\\_snapshot/](https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/); Government Accountability Office (GAO), GAO-16-674, *Supplemental Security Income, SSA Provides Benefits to Multiple Recipient Households but Needs System Changes to Improve Claims Management* 52, Table 10 (Aug. 2016).
- 71 GAO-16-674, *Supplemental Security Income, SSA Provides Benefits to Multiple Recipient Households but Needs System Changes to Improve Claims Management* 52, Table 10 (Aug. 2016), reporting that where multiple household members receive SSI, the estimated average amount of earned and unearned income for the household is \$622, with a range of between \$560 and \$684 at the 95 percent confidence level. In one-recipient households, the estimated average monthly earned and unearned income is \$457, with a range of between \$440 and \$473 at the 95 percent confidence level.
- 72 IRM 5.11.7.2.1.1(e), *IRS/BFS Interagency Agreement - Federal Payments Subject to the FPLP* (Sept. 23, 2016); SSI payments are exempt from levy under IRC § 6334(a)(11), except as provided in IRC § 6331(h) for FPLP levies.
- 73 Because SSI payments are not reported to the IRS, IRS databases do not identify taxpayers with federal tax debt whose SSI payments are exempt from levy.
- 74 See, e.g., IRS, *Phone Scams Continue to be Serious Threat, Remain on IRS “Dirty Dozen” List of Tax Scams for the 2015 Filing Season* (Jan. 22, 2015), <https://www.irs.gov/uac/newsroom/phone-scams-continue-to-be-serious-threat-and-remain-on-irs-dirty-dozen-list-of-tax-scams-for-the-2015-filing-season>, (warning taxpayers that scammers “prey on the most vulnerable people, such as the elderly, newly arrived immigrants and those whose first language is not English”).
- 75 See Research Study: *IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies*, vol. 2, *infra*.

percent of the federal poverty level. The IRS argued that these taxpayers may have significant assets that would enable them to make payments from income (notwithstanding that the IRS itself has long excluded these taxpayers' accounts from FPLP levies). The National Taxpayer Advocate pointed out that the IRS could create a filter or algorithm (as TAS had done in past research studies) to identify taxpayers whose Form 1099 documents indicate the existence of assets above a certain value.<sup>76</sup> The Commissioner decided that for the first six months of the program, these taxpayers would be included in the PCA inventory; during that time, the IRS could explore how to screen for SSA recipients with incomes below 250 percent of the federal poverty level who also have substantial assets.

The National Taxpayer Advocate, while pleased with the exclusions of SSDI and SSI recipients, continues to be concerned about the harm to low income recipients of SSA retirement payments. The future earnings of low income retirees are generally quite limited, so if they pay more than they can reasonably afford in response to PCA pressure — as some inevitably will do — they may end up in economic hardship and remain unable to pay basic living expenses for extended periods of time. Therefore, TAS is developing outreach materials for Local Taxpayer Advocates as well as stakeholder groups and nonprofits who serve these populations. In this way, taxpayers or their caretakers or representatives will learn they do not have to pay the IRS — or PCAs — where the taxpayer is experiencing economic hardship.

### The IRS's Private Debt Collection (PDC) Program Undermines TAS and Jeopardizes Taxpayer Rights

#### *The IRS Does Not Intend to Systemically Prevent Accounts of Taxpayers Who Currently Have Cases Pending in TAS From Being Assigned to PCAs*

Under IRC § 7811, the National Taxpayer Advocate has the authority to issue a Taxpayer Assistance Order (TAO) if she determines the taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the IRS is administering internal revenue laws.<sup>77</sup> "Significant hardship" means:

- (A) an immediate threat of adverse action;
- (B) a delay of more than 30 days in resolving taxpayer account problems;
- (C) the incurring by the taxpayer of significant costs (including fees for professional representation) if relief is not granted; or
- (D) irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted.<sup>78</sup>

Once TAS opens a case, it works *all* of the taxpayer's issues to completion pursuant to procedures that have been in place since TAS's inception.<sup>79</sup> TAS does not close the case until all the issues have been resolved, which may culminate in the issuance of a TAO. For example, a taxpayer who is currently in

<sup>76</sup> See National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*). Moreover, the IRS does not always insist that a taxpayer demonstrate a lack of income-generating assets from which to pay a tax liability. See Rev. Proc. 2015-57, 2015-51 I.R.B. 863, which allows certain taxpayers whose Federal student loans are discharged to exclude the discharged amount from gross income. The guidance notes that most borrowers whose loans are discharged "would be able to exclude from gross income all or substantially all of the discharged amounts based on fraudulent misrepresentations made by the colleges to the students, the insolvency exclusion, or another tax law authority." However, "determining whether one or more of these exceptions is available to each affected borrower would require a fact intensive analysis of the particular borrower's situation to determine the extent to which the discharged amount is eligible for exclusion under each of the potentially available exceptions. The Treasury Department and the IRS are concerned that such an analysis would impose a compliance burden on taxpayers, as well as an administrative burden on the IRS, that is excessive in relation to the amount of taxable income that would result."

<sup>77</sup> See IRC § 7811(a)(1).

<sup>78</sup> See IRC § 7811(a)(2).

<sup>79</sup> See e.g., IRM 13.1.19.5.4, *Case Advocate OAR Responsibilities* (May 5, 2016).

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**Paying private collection agencies (PCAs) a 25 percent commission for work that was or will need to be accomplished by the IRS constitutes a windfall to the PCAs.**

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the collection queue may need assistance with requesting penalty abatement or audit reconsideration, which may eliminate or significantly reduce a balance due. Typically, TAS works with the taxpayer to gather and submit the necessary documentation and analysis with an Operations Assistance Request (OAR) to the IRS operating division that controls the case. If a balance due remains, TAS case advocates have the delegated authority to place taxpayers into streamlined IAs (*i.e.*, IAs up to six years in length).<sup>80</sup> If the taxpayer does not qualify for a streamlined IA but may qualify for a non-streamlined IA, TAS works with the taxpayer to gather the taxpayer's financial information and then submits the information to the IRS with an OAR, requesting the IRS enter into a non-streamlined IA. TAS case advocates follow similar procedures for handling CNC-Hardship cases and Offers in Compromise based on doubt as to collectability. If necessary, the National Taxpayer Advocate or her delegates issue TAOs to resolve these cases. Thus, there is no reason to assign active TAS cases to PCAs — TAS has all the tools to resolve the cases efficiently and effectively, as is required by IRC § 7803(c).

Additionally, assigning open TAS cases to PCAs means taxpayers may be contacted by PCAs while they are working with TAS. This will create confusion for taxpayers and more work for the IRS and TAS as taxpayers contact the IRS and TAS for information about how to proceed. Taxpayers will feel angry at being “shuttled” from TAS to a PCA, especially when they have been assured that collection activity will cease while the case is pending in TAS, a practice that has existed between the IRS and TAS since TAS's inception in 1998. Moreover, assigning open TAS cases to PCAs may mean that PCAs may receive commissions on payments taxpayers make as a result of TAS's and the IRS's work — resulting in a windfall for PCAs and a drain on the public fisc.

To avert these inefficiencies, and to avoid undermining taxpayer confidence in TAS and the IRS, TAS requested that the IRS assign a transaction code for open TAS cases. The transaction code could be used to systemically prevent a TAS case from being included in PCA inventory for the period of time the case is open in TAS. TAS would adopt procedures to ensure the code would be placed on the account when the case is first opened in TAS, and removed when TAS closes the case. Thus, if the collection issue is closed unresolved in TAS, or if the taxpayer is unresponsive or uncooperative, the account could be returned to the pool of PCA-eligible accounts. At the time this report goes to print, there is general agreement to exclude TAS cases from PCA inventory, yet despite two meetings with the Commissioner and other senior IRS officials, there is no agreement as to whether the IRS will use a transaction code for TAS cases. The National Taxpayer Advocate and her staff will continue to press the IRS to move forward with programming this transaction code and developing procedures and training for both PCAs and TAS employees.

***The IRS Has Not Provided Adequate Guidance to PCAs on When to Refer a Taxpayer to TAS and Does Not Intend to Recall Accounts From PCAs When the Taxpayers Request Assistance From TAS***

As discussed below, PCAs are required to refer a taxpayer to TAS when the taxpayer “indicates” that payment of the balance due immediately or through a payment arrangement would leave him or her unable to pay necessary living expenses.<sup>81</sup> Alternatively, a taxpayer whose case has been assigned to a PCA may independently contact TAS or the IRS. TAS will open a case for that taxpayer if a TAS

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<sup>80</sup> See IRM 13.1.4.2.3.9, *Installment Agreements* (Oct. 31, 2004). Streamlined installment agreements, generally available for individual taxpayers when the total tax liability is \$50,000 or less, do not require a financial statement. See IRM 5.14.5.2, *Streamlined Installment Agreements* (Dec. 23, 2015).

<sup>81</sup> PPG § 12.3, *Unable to Pay* (discussed below).

case acceptance criterion is met (*e.g.*, the taxpayer is experiencing economic harm or is about to suffer economic harm).<sup>82</sup>

Our first concern is that the PPG violates both IRC §§ 6306 and 7811 by adopting a narrow definition of when a case should be referred to TAS. Taxpayers are eligible for TAS assistance when they are experiencing or are about to experience significant hardship, as defined by IRC § 7811, the regulations thereunder, and the related TAS IRM.<sup>83</sup> Significant hardship includes both economic and systemic burdens, and contemplates more than just being unable to meet one's basic living expenses. Moreover, IRC § 6306 provides that a qualified tax collection contract "prohibits each person providing such services under such contract from committing any act or omission which employees of the Internal Revenue Service are prohibited from committing in the performance of similar services."<sup>84</sup> By not providing guidance and training to PCA employees on the full definition of significant hardship (and required referrals to TAS), the IRS operates in a manner not authorized by IRC § 6306 and also violates taxpayers' *right to a fair and just tax system*, which includes the "right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels."<sup>85</sup>

Our second concern relates to what happens to PCA cases once the taxpayer is referred to TAS. TAS requested that the IRS adopt procedures to recall these TAS cases from the PCAs, as its contract with PCA permits.<sup>86</sup> PCAs should not receive windfall compensation attributable to work that is actually done by TAS or the IRS (as is the case where an OAR is issued). If the IRS does not honor the National Taxpayer Advocate's request to recall cases from PCAs when they seek assistance from TAS and TAS opens a case, the National Taxpayer Advocate may issue TAOs to the IRS and PCAs to achieve that result.<sup>87</sup>

### Provisions in the IRS's Contracts With Private Collection Agencies (PCAs) Burden Taxpayers and Tax Administration

The following aspects of the planned PDC program compromise taxpayer rights and increase burden on both taxpayers and tax administration:

- PCAs are not required to return to the IRS accounts of taxpayers in economic hardship. The PPG provides that a PCA *may* return an account to the IRS if the PCA deems the taxpayer is unable to pay and has exhausted all reasonable collection efforts, but the guide does not elaborate on what

82 IRM 13.1.7.2, *TAS Case Criteria* (Feb. 4, 2015).

83 IRC § 7811(a)(2); Treas. Reg. §301.7811-1(a)(4); IRM 13.1.2.3.3, *Significant Hardship* (Jan. 27, 2009).

84 IRC § 6306(b)(2).

85 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

86 The contract with the PCAs, in Section III, *Performance Work Statement Tax Collection Services*, in part 4.3.9.1, includes "Taxpayer Advocate Service (TAS)" among the reasons why the IRS would recall an account. The other examples of reasons why the IRS would recall an account are those enumerated in IRC § 6306(d) as accounts not eligible for assignment to PCAs (*e.g.*, because there is a pending or active installment agreement or offer in compromise, a pending request for innocent spouse relief, the taxpayer is deceased, under age 18, the victim of identity theft, in a designated combat zone, *etc.*).

87 The 2004 legislation that gave the IRS authority to use PCAs also amended IRC § 7811 to provide that the National Taxpayer Advocate's Taxpayer Assistance Order (TAO) authority extends to PCAs. IRC § 7811(g), added by the American Jobs Creation Act of 2004, Pub. L. 108-357, Title VIII, § 881(c), 118 Stat. 1418, 1626-7 provides: "Application to persons performing services under a qualified tax collection contract. Any order issued or action taken by the National Taxpayer Advocate pursuant to this section shall apply to persons performing services under a qualified tax collection contract (as defined in section 6306(b)) to the same extent and in the same manner as such order or action applies to the Secretary." IRC § 6306(k)(2) was also added, cross referencing IRC § 7811(g).

the PCA employee should consider when determining if a taxpayer is unable to pay.<sup>88</sup> Because PCAs will earn a commission on those payments, PCA employees have no incentive to inquire into the taxpayer's economic condition.

- The IRS does not require transparency of PCA procedures. The IRS has committed to providing PCA calling scripts to TAS for review, but it remains to be seen whether that commitment will include providing operational plans or other information that contains materials, such as calling scripts, that provide the framework for PCAs' contacts with taxpayers.<sup>89</sup>
- The IRS will pay commissions on taxpayer remittances prompted by IRS action rather than PCA action. PCAs may not contact taxpayers or receive commissions on payments made by taxpayers for ten calendar days after the PCA receives the account.<sup>90</sup> In the ten-day interim period, the IRS notifies the taxpayer that it assigned the account to a PCA. The letter from the IRS, rather than any action by the PCA, may trigger payments by taxpayers, yet the PCA will receive a commission on the payments as long as they are received after the ten-day period.
- Unlike during the 2006-2009 iteration of the PDC program, the IRS will not use a Referral Unit to facilitate interactions with PCAs, and there is no clear procedure for penalizing PCAs for conduct that generates taxpayer complaints.<sup>91</sup> This means there will be no assistance from the IRS in determining whether a taxpayer should be treated as unable to pay. Moreover, taxpayers requesting penalty abatement, audit reconsiderations, or military deferment will likewise be directed to file a request directly with the IRS, in which case the PCA will suspend collection activity for 60 days while the IRS considers the abatement or deferral request. For FY 2016, it took 91 days on average for the IRS to respond to correspondence from individual taxpayers.<sup>92</sup> Thus, the taxpayer may need to make multiple contacts with the PCA just to extend the 60-day period. This burden could be avoided by the IRS simply by recalling the case pending the outcome of the audit reconsideration or other determination.
- Cases recalled from PCA inventory will not be worked to completion. After a taxpayer requests not to work with PCAs, his or her account will be returned to the same inactive status from which it originated, thus "potentially contributing to a perception that ignoring tax collection may be a successful strategy."<sup>93</sup> Taxpayers may conclude that the IRS, although it alerted them to their tax debt and placed their account with a PCA, is not actually interested in working with them to resolve it.

88 PPG § 12.3, *Unable to Pay*.

89 Letter from Scott Prentky, Director, Collection to Chi Chi Wu, Staff Attorney, National Consumer Law Center (Sept. 12, 2016).

90 Section 5.3, *Initial Contact Letters* PCA Policy and Procedures Guide; Section 4.1 of PCA contracts (providing "[t]he Contractor shall receive commission on any payment received 11 calendar days or more after the date the account is transferred to the Contractor.").

91 Section 1203 of the IRS Restructuring and Reform Act of 1998 specified ten acts or omissions (known as the "10 Deadly Sins") for which an IRS employee is to be fired, most of which involve mistreatment of taxpayers. IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. 105-206, § 1203, 112 Stat. 685, 720-721. As the GAO has noted: "Most, but not all, of the acts or omissions involve mistreatment of taxpayers." GAO, GAO-04-1039R, *IRS' Efforts to Evaluate the Section 1203 Process for Employee Misconduct and Measure Its Impacts on Tax Administration* 1 (2004). There is no statutory or contractual requirement that PCAs fire employees who are found to have mistreated taxpayers.

92 IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

93 National Taxpayer Advocate 2008 Annual Report to Congress 328, 331 (Status Update: *The IRS's Private Debt Collection Initiative is Failing in Most Respects*).



## CONCLUSION

The IRS, in carrying out the congressional mandate that it outsource collection of certain tax debts, is implementing a program that is inconsistent with the statutory definition of which activities the PCAs are authorized to conduct. Moreover, the IRS is not taking adequate measures to prevent PCAs from receiving the accounts of taxpayers against whom the IRS would not normally seek to collect through automatic levies because they are likely to be experiencing economic hardship. The IRS also is not adequately training PCA employees on TAS referral criteria, or adopting adequate procedures for recalling cases from the PCAs where a taxpayer is accepted into TAS.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise the PPG to allow PCAs to offer IAs of up to five years — rather than for the period that remains on the collection statute expiration date — to comply with the law.
2. Revise the PPG to clarify that PCAs are not authorized to monitor IAs arranged by the IRS or TAS, and are not entitled to commissions on payments taxpayers make pursuant to those IAs.
3. Revise the PPG to remove the option of soliciting voluntary payments that do not satisfy the liability and are not made pursuant to an IA in order to comply with the law.
4. Revise the PPG to provide that PCAs must refer taxpayers to TAS where the taxpayer so requests, where payment of the balance due immediately or through a payment arrangement would create a significant hardship, including long term or adverse impact, where the taxpayer is unable to pay necessary living expenses, or where the taxpayer is experiencing systemic burden in resolving his or her issue.
5. Assign a Master File code to open TAS cases and systemically prevent open TAS cases from being assigned to PCAs.
6. Recall cases from PCAs when taxpayers request assistance from TAS and TAS opens a case.
7. Implement the necessary programming as soon as possible to remove recipients of SSDI or SSI payments from the population of accounts that are eligible for assignment to PCAs.
8. Adopt an interpretation of “potentially collectible inventory” that excludes the accounts of taxpayers whose SSA and RRB retirement benefits are not subject to FPLP levies because their incomes are less than 250 percent of the federal poverty level and develop a filter to identify those who appear to have significant assets.
9. Revise the contract with PCAs to require PCAs to disclose all materials that impact taxpayers’ contacts with PCAs, including operational plans, training materials, instructions to staff, the content and format of taxpayer letters, and calling scripts.
10. Include in required training for all PCA employees the National Taxpayer Advocate’s taped training on taxpayer rights.
11. Send taxpayers whose accounts will be assigned to PCAs the IRS initial contact letter at least 14 days before transferring their accounts to PCAs and do not pay commissions to PCAs on any payments received after the initial IRS contact letter is sent and before the first PCA contact with the taxpayer.
12. Designate a group of Collection employees to work to completion cases that are recalled from PCAs.



MSP  
#13**ALLOWABLE LIVING EXPENSE (ALE) STANDARD: The IRS's Development and Use of ALEs Does Not Adequately Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Households While Complying With Their Tax Obligations****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

**TAXPAYER RIGHT(S) IMPACTED<sup>1</sup>**

- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

Internal Revenue Code (IRC) § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”<sup>2</sup> Most importantly, Congress instructed the IRS to analyze the facts of each case involving these allowances and stipulated that if application of the allowances results in a taxpayer not being able to provide for basic living expenses, then the allowances should not be used.<sup>3</sup> The resulting Allowable Living Expense (ALE) standards have come to play a major role in analyzing several types of IRS collection cases.<sup>4</sup> Moreover, the IRS ALEs have been incorporated into several non-tax government programs.<sup>5</sup>

The IRS allows an expense if it is “necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.”<sup>6</sup> In its efforts to base the allowed expenses on reliable and consistent data, the IRS relies heavily on the Bureau of Labor Statistics (BLS). In particular, the IRS uses the Consumer Expenditure Survey (CES), which gathers expenditure information for consumers.<sup>7</sup> Since this survey measures what people spend to live, it does not take into account what the goods or

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See also Treas. Reg. § 301.7122-1(c)(2)(i).

3 IRC § 7122(d)(2)(B).

4 Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, is used to determine monthly expenses and primarily relies on the ALE standards. This form is necessary for many types of case resolutions, including certain installment agreements and offers in compromise (OIC). Internal Revenue Manual (IRM) 5.15.1.1(3), *Overview and Expectations* (Nov. 17, 2014).

5 For instance, debtors filing for bankruptcy are instructed to use the IRS’s ALE standards to calculate income and expenses. 11 U.S.C. § 707(b)(2). Additionally, when a debtor to a federal student loan is subject to a proposed wage garnishment, that debtor may object to the proposed garnishment by arguing it would create a financial hardship. 34 C.F.R. § 34.24(a). The debtor must provide credible documentation showing, among other things, his or her basic living expenses as established by the IRS’s ALE standards. 34 C.F.R. § 34.24(e)(2).

6 IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012).

7 BLS, *CES Frequently Asked Questions*, <http://www.bls.gov/cex/csxfaq.htm#q1>.

services actually cost to live. Taxpayers of limited means pay for what they can afford and thus may forego expenses otherwise determined by the IRS definition to be necessary.

By focusing on what expenses are *allowable* instead of *adequate*, the IRS has exercised its discretion in a way that does not comport with congressional intent, since “allowable” is not synonymous with “adequate” or “basic.”<sup>8</sup> Instead, the IRS should adopt standards that allow for a *sufficient* or *adequate* standard of living.<sup>9</sup>

The National Taxpayer Advocate has the following concerns with the current ALE standards:

- Taxpayers of limited means are harmed because the current ALEs are based on data that reflect what taxpayers spend, rather than what they actually need to spend to maintain the health and welfare of their households;
- The current ALEs do not reflect an understanding of what amount of money is sufficient to maintain a basic lifestyle;
- The ALEs do not account for the income and expenditure fluctuations within and between income levels and other household demographics;
- The ALEs should be updated to include expenses necessary to maintain the health and welfare of households today, including an allocation for digital access and technology, child care, and retirement savings; and
- Alternative methods to measure household health and welfare provide better insight into necessary expenses and establish the expenses as a floor, rather than a cap.<sup>10</sup>

A reevaluation of the ALE standards is crucial, given the IRS’s Future State initiative, which focuses on increasing online tools and reducing telephone and face-to-face interactions with taxpayers.<sup>11</sup> If the ALE standards do not reflect the financial realities of taxpayers, then increased use of online tools and automated programs based on these ALEs will exacerbate the financial harm to these taxpayers. IRC § 7122(d)(2)(B) requires that the IRS make decisions involving the ALE standards on a case-by-case basis. Heavy reliance on online accounts reduces the opportunity for a person-to-person exchange that will identify the financial circumstances necessary for a case-by-case analysis, and the appropriate application of, or deviation from, allowable expenses standards.

8 Congressional intent for maintaining an adequate and basic standard of living can be seen in how Congress has addressed “economic hardship” for IRS Collection purposes, which is defined as an inability to pay “reasonable basic living expenses.” Treas. Reg. § 301.6343-1(b)(4).

9 “Sufficient” is defined as “adequate; of such quality, number, force, or value as is necessary for a given purpose.” Whereas, “allowable” is defined as “acceptable according to the rules; permissible.” BLACK’S LAW DICTIONARY (10th ed. 2014).

10 The National Taxpayer Advocate raised concerns about the ALE standards when Congress was contemplating the change to IRC § 7122 in 1998. As Executive Director of The Community Tax Law Project, the National Taxpayer Advocate testified that “The impact of the current standards is illustrated by a recent case in which I represented an individual who lived in a blighted inner-city neighborhood and used public transportation. The ACS [Automated Collection Service] employee refused to allow his bus fare for travel to a grocery store at the shopping mall, although he needed to go there in order to keep his food expenses within the IRS guidelines.” *IRS Restructuring: Hearings Before the Comm. on Finance*, 105th Cong. 333 (1998) (statement of Nina E. Olson, Executive Director, The Community Tax Law Project).

11 IRS, *Future State Initiative*, <https://www.irs.gov/uac/newsroom/future-state-initiative>.

## ANALYSIS OF PROBLEM

### Background

As mentioned above, IRC § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.” Additionally, the pertinent section of Treasury Regulations reads as follows:

A determination of doubt as to collectibility will include a determination of ability to pay. In determining ability to pay, the Secretary will permit taxpayers to retain *sufficient* funds to pay basic living expenses. The determination of the amount of such basic living expenses will be founded upon an evaluation of the individual facts and circumstances presented by the taxpayer’s case. To guide this determination, guidelines published by the Secretary on national and local living expense standards will be taken into account.<sup>12</sup> (Emphasis added).

To fulfill Congress’s mandate in IRC § 7122(d)(2)(A), the IRS developed a system of expenses which must meet the “necessary test.” The IRS considers an expense to be necessary if it is “necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.”<sup>13</sup> The necessary test is an exercise of IRS discretion and is not found in the U.S. Tax Code or Treasury Regulations.

The IRS further divides expenses into three categories: ALEs, other necessary expenses, and other conditional expenses.<sup>14</sup> This discussion will focus on ALEs.

There are ALEs for items such as food and clothing, housing and utilities, and transportation.<sup>15</sup> Expenses for food, clothing, and other miscellaneous items, as well as for out-of-pocket healthcare expenses, are based on national standards. These standards come from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES).<sup>16</sup> For these expenses, the taxpayer is allowed the total national standard without questioning the amount he or she actually spends (as long as the taxpayer does not spend more than the standard amount).<sup>17</sup>

Housing and utility expenses and transportation costs are based on Census and BLS data by county.<sup>18</sup> One downside to using county-based measurements is that there can be wide variations in cost within one county. In 2014, one report found that rents for one and two bedroom apartments in Orange County,

12 Treas. Reg. § 301.7122-1(c)(2)(i).

13 IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012).

14 “Other necessary expenses” are expenses that meet the necessary expense test and are normally allowed. This is the category for child care costs, which are allowed if they are “reasonable,” making them subject to an individual IRS employee’s judgment. Conditional expenses are expenses which may not meet the necessary expense test, but may be allowed based on the circumstances of an individual case. IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012).

15 IRM 5.15.1.7, *Allowable Expense Overview* (Oct. 2, 2012).

16 The BLS is part of the United States Department of Labor. United States Department of Labor, *About BLS*, <http://www.bls.gov/bls/infohome.htm>. Out-of-pocket healthcare expenses are based on Medical Expenditure Panel Survey data, which comes from the U.S. Department of Health and Human Services. IRM 5.15.1.7 (Oct. 02, 2012). The CES program “consists of two surveys, the Quarterly Interview Survey and the Diary Survey, that provide information on the buying habits of American consumers, including data on their expenditures, income, and consumer unit (families and single consumers) characteristics.” BLS, CES, <http://www.bls.gov/cex/> (last visited Sept. 9, 2015).

17 IRM 5.15.1.7(3), *Allowable Expense Overview* (Oct. 2, 2012).

18 IRM 5.15.1.7(4), *Allowable Expense Overview* (Oct. 2, 2012). In addition to mortgage or rent, housing expenses include such things as utilities (gas, electricity, water, etc.), garbage removal, cable television, internet service, telephone, and cell phone.

California varied between \$858 to more than \$2,000 in Santa Ana and between \$1,325 to more than \$3,000 in Lake Forest.<sup>19</sup>

Transportation costs consist of nationwide figures for loan or lease payments and additional amounts for operating costs broken down by Census Region and Metropolitan Statistical Area. Taxpayers are generally allowed the local standard or what they actually pay each month, whichever is less.<sup>20</sup> If the amount claimed is more than the total allowed by the standards, the taxpayer must provide documentation to substantiate those expenses are necessary.<sup>21</sup> Thus, the local standards for housing and transportation expenses serve as a cap on what taxpayers can claim.

*Taxpayers of Limited Means Are Harmed Because the Current ALEs Are Based on Data That Reflect What Taxpayers Spend, Rather Than What They Actually Need to Spend to Maintain the Health and Welfare of Their Households*

Deviation from application of the standards is allowed when, based on a taxpayer's facts and circumstances, such application would create an economic hardship for the taxpayer.<sup>22</sup> However, commentators and practitioners observe that many IRS employees do not exercise flexibility in determining when to make a deviation. For instance, the Internal Revenue Service Advisory Council (IRSAC) noted that employees in Automated Collection Service (ACS) seem less likely to be flexible than revenue officers, but Appeals employees are "more likely" to deviate from the standards.<sup>23</sup> The National Taxpayer Advocate has also addressed concerns with the use and application of ALE standards in individual taxpayer cases.<sup>24</sup>

One tax attorney testified before Congress that a strict adherence to ALE standards can cause taxpayers to file bankruptcy unnecessarily.<sup>25</sup> The harm that taxpayers experience when a deviation does not occur was also seen in *Leago v. Commissioner*.<sup>26</sup> In *Leago*, the taxpayer did not contest that he owed a tax liability of approximately \$94,433. However, Mr. Leago suffered from a brain tumor that required surgery estimated to cost \$100,000. Mr. Leago had no health insurance. As part of a collection due process (CDP) hearing in response to a proposed levy, Mr. Leago requested that his liability be classified as currently not collectable (CNC) due to financial hardship and health problems, which the IRS did not agree to do.<sup>27</sup> The Tax Court remanded the case back to Appeals for a supplemental CDP hearing. The settlement officer excluded any expenses for health care because Mr. Leago was not currently paying these expenses

19 Internal Revenue Service Advisory Council (IRSAC), *General Report* 80 (Nov. 19, 2014).

20 IRM 5.15.1.9, *Local Standards* (Nov. 17, 2014).

21 IRM 5.15.1.9(1)(a), *Local Standards* (Nov. 17, 2014).

22 IRC § 7122(d)(2)(B); IRM 5.15.1.1(7) (Nov. 17, 2014).

23 IRSAC, *General Report* 83 (Nov. 19, 2014). See also IRS, Small Business/Self Employed (SB/SE) Research, *Final Report: Assessing the Impact of the Allowable Living Expense Standards Focus Group*, NCH0160 (Dec. 2010).

24 National Taxpayer Advocate Objectives Report to Congress Fiscal Year (FY) 2017 131-35 (Area of Focus: *The IRS Should Reevaluate How It Develops and Uses Allowable Living Expense Standards*); National Taxpayer Advocate 2006 Annual Report to Congress 83-109 (Most Serious Problem: *IRS Collection Payment Alternatives*); National Taxpayer Advocate 2005 Annual Report to Congress 270-91 (Most Serious Problem: *Allowable Expense Standards for Collection Decisions*).

25 *Practices and Procedures of the Internal Revenue Service: Hearings Before the Comm. on Finance*, 105th Cong. 39 (1997) (statement of Robert Schriebman, tax attorney).

26 T.C. Memo. 2012-39.

27 Prior to levying a taxpayer's property, in most instances, the IRS must provide the taxpayer with an opportunity to have a hearing before Appeals. During this hearing, the taxpayer may raise various issues, including alternative collection options to the levy. IRC § 6330.

and instead offered him a partial-pay installment plan (PPIA) in the amount of \$200 per month. Mr. Leago declined to accept this payment plan.<sup>28</sup>

Throughout the process, the IRS failed to acknowledge the cost of a life-saving surgery for Mr. Leago because he simply could not afford it. That is, because Mr. Leago was not currently paying toward the cost of having brain surgery, the IRS refused to include the necessary expense in its calculation of basic living expenses, thereby placing payment of a federal debt above the necessary (future) expenses to preserve the taxpayer's health and ensuring the taxpayer would not be able to afford a necessary surgery. Today, this IRS action would violate the taxpayer's *right to privacy*, which ensures that IRS enforcement action will be no more intrusive than necessary. Additionally, another taxpayer with the ability to pay for the surgery could have received a different outcome in his or her financial analysis than Mr. Leago, in violation of Mr. Leago's *right to a fair and just tax system*.

As it is now, the standards are based on the average or median expenditures derived from U.S. government data sources (e.g., U.S. Census Bureau or the BLS) representing the actual expenditures of broad segments of the population and not what individual goods and services actually cost. While this approach may seem reasonable at first glance, the National Taxpayer Advocate previously expressed concerns that, in reality, the application of these standards to individual taxpayer cases may lead to erroneous conclusions regarding the appropriate use of reasonable collection payment alternatives.<sup>29</sup>

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By focusing on what expenses are *allowable* instead of *adequate*, the IRS has exercised its discretion in a way that does not comport with Congressional intent, since “allowable” is not synonymous with “adequate” or “basic.”

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By focusing on what taxpayers actually pay instead of what a “basic living” service or good actually costs, the financial circumstances of some taxpayers, such as those who must forego paying certain basic living expenses to make ends meet, are not fully realized. If a taxpayer does not have sufficient funds to meet all of his or her necessary costs of living, the taxpayer should not be treated differently than a taxpayer who can afford to pay for all of his or her necessary costs of living.<sup>30</sup>

Alternatively, some taxpayers may incur expenses that are higher than the average.<sup>31</sup> These taxpayers should not be forced to reduce their standard of living to the poverty level in order to pay their taxes. Without knowing what constitutes the standard of living required to maintain the health and welfare of a household, it is not possible to determine if a taxpayer has paid too little or too much for an expense.

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28 Subsequently, Mr. Leago proposed an OIC based on doubt as to collectibility with special circumstances. In his collection information sheet (CIS), he reported \$3,100 per month for future expenses related to his brain surgery. T.C. Memo. 2012-39 at 4. The settlement officer who reviewed this offer again denied the future medical expense because it represented an amount Mr. Leago was not currently paying. T.C. Memo. 2012-39 at 5. The court again remanded the case. T.C. Memo. 2012-39 at 9. The court opinion does not shed light on the outcome for Mr. Leago after the second remand.

29 National Taxpayer Advocate 2005 Annual Report to Congress 270-91; National Taxpayer Advocate 2006 Annual Report to Congress 83-109.

30 It may seem that trying to survive below basic living standards is a situation reserved for only a small population of taxpayers. In fact, the opposite is true. One estimate is that 59 percent of Americans will encounter a year or more of poverty by the time they are 75 years old. Mark Rank, *Rethinking the Scope and Impact of Poverty in the United States*, 6 CONN. PUB. INT. L.J. 165, 171 (2007).

31 The ALE standards may also fail to acknowledge that some taxpayers “need to maintain higher professional standards in their dress, personal appearance, and vehicle, so that for production of income, a realtor, corporate executive, or physician may have different ‘necessary expenses.’” IRSAC, *General Report* 84 (Nov. 19, 2014).

*The Current ALEs Do Not Reflect an Understanding of What Amount of Money Is Sufficient to Maintain a Basic Lifestyle*

Before the IRS can establish a standard for living expenses, it must understand what amount of money is sufficient for a basic standard of living. The IRS has not established how much it costs to maintain a basic standard of living. As a baseline, the United States often uses the poverty threshold to determine if a person has enough money to survive day-to-day. A person is considered to be living in poverty if his or her family's income falls below an income threshold set up by family size and composition.<sup>32</sup> The current method for determining the poverty level was developed between 1963 and 1964 by Mollie Orshansky, an economist at the Social Security Administration (SSA).<sup>33</sup> The official measure multiplies by three the cost of a minimum food diet from 1963 prices in today's prices.<sup>34</sup> The poverty threshold is not a measure of a sufficient standard of living.

In 2010, the Census Bureau introduced the Supplemental Poverty Measure (SPM) which extends the official poverty measure by taking into consideration government benefits and expenses that are not in the official measure.<sup>35</sup> The SPM was the result of mounting concerns over the inadequacy of the official poverty measure.<sup>36</sup> Instead of focusing on minimal food costs from 1963, the SPM considers the "mean of expenditures on food, clothing, shelter, and utilities (FCSU) over all two child consumer units in the 30th to 36th percentile range multiplied by 1.2."<sup>37</sup> Additionally, income is not measured just by pre-tax cash income but also includes noncash government benefits, taxes, and expenses related to work.<sup>38</sup> The SPM serves as an acknowledgement that the current poverty threshold cannot be used on its own to measure poverty.

What was sufficient to maintain a basic, healthy standard of living in 1963 has evolved over time. In 1963, families spent one-third of their budget on food. By 2004, it was reported that food expenditures had fallen to about one-seventh of total expenditures.<sup>39</sup> Currently, food represents only ten percent of a family's expenses.<sup>40</sup>

32 U.S. Census Bureau, *How the Census Bureau Measures Poverty*, <http://www.census.gov/topics/income-poverty/poverty/guidance/poverty-measures.html>. U.S. Census Bureau, *Measuring America: How Census Measures Poverty* (Jan. 2014), [http://www.census.gov/library/visualizations/2014/demo/poverty\\_measure-how.html](http://www.census.gov/library/visualizations/2014/demo/poverty_measure-how.html).

33 Gordon M. Fisher, *The Development and History of the Poverty Thresholds*, 55 Soc. Sec. Bull. 3 (Winter 1992).

34 U.S. Census Bureau, *Measuring America: How Census Measures Poverty* (Jan. 2014), [http://www.census.gov/library/infographics/poverty\\_measure-how.html](http://www.census.gov/library/infographics/poverty_measure-how.html). Food was chosen as the original standard of adequacy because it was the only generally accepted standard available at the time. Mollie Orshansky, *Counting the Poor: Another Look at the Poverty Profile*, 28 Soc. Sec. Bull. 5 (1965). The multiplier of three for costs of food was used since research at the time showed that families spent one-third of their budget on food. *Id.* at 9. For a discussion on how Ms. Orshansky came to this decision, see Gordon M. Fisher, *The Development and History of the Poverty Thresholds*, 55 Soc. Sec. Bull. 5 (Winter 1992).

35 U.S. Census Bureau, *The Supplemental Poverty Measure: 2014*, 1 (Sept. 2015).

36 *Id.*

37 *Id.* at 2.

38 *Id.*

39 Douglas J. Besharov and Peter Germanis, *Reconsidering the Federal Poverty Measure*, 9 (June 14, 2004).

40 The Pew Charitable Trusts, *Household Expenditures and Income*, 5 (Mar. 2016).



The IRS's recent decision to decrease some ALE standards highlights the difficulties in identifying and measuring what it costs to maintain a basic standard of living.<sup>41</sup> The IRS decreased the amounts for some of the allowable expenses based on "current data showing a decline in expenditures."<sup>42</sup> Between 2015 and 2016, the expenses allowed for out-of-pocket healthcare and transportation decreased, as did the national standards for food, clothing, housekeeping supplies, and miscellaneous.<sup>43</sup> TAS is unaware of how IRS assumptions can be tested using the current system of ALE standards, since the standards are based on averages spent by consumers, rather than an analysis of what individuals and families actually need in order to provide for a basic living.

It is not apparent that expenditures have actually declined. One source has reported on the impact of the Great Recession. It found that from 2004 to 2008, median household income grew by 1.5 percent while median expenditures grew by 11 percent.<sup>44</sup> However, the 2014 median income has *decreased* by 13 percent from 2004 levels while expenditures increased by nearly 14 percent.<sup>45</sup>

As an example, the cost of child care expenses has increased. Average weekly child care expenses for families with working mothers who paid for child care rose more than 70 percent from 1985 (\$87) to 2011 (\$148).<sup>46</sup> This increase is felt to varying degrees based on income. Families with employed mothers whose monthly income was \$4,500 or more paid an average of \$163 a week for child care, representing 6.7 percent of their family income. Families with monthly income of less than \$1,500 paid much less (\$97 a week on average) but that represented 39.6 percent of their family income.<sup>47</sup>

### *The ALEs Do Not Account for the Income and Expenditure Fluctuations Within and Between Income Levels and Other Household Demographics*

The BLS, which is a primary source for ALE data, advises caution in interpreting its consumer expenditure data when relating averages to individual circumstances. The warning reads:

Caution should be used in interpreting the expenditure data, especially when relating averages to individual circumstances. The data shown in the published tables are averages for demographic groups of consumer units. Expenditures by individual consumer units may differ from the average even if the characteristics of the group are similar to those of the

41 IRS, *Collection Financial Standard* (March 2016), [https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards?\\_ga=1.142286002.1851601558.1476275435](https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards?_ga=1.142286002.1851601558.1476275435). Also in 2015, the IRS announced plans to deviate from normal procedures in Automated Collection System (ACS), Automated Collection System Support (ACSS), and Compliance Services Collection Operations (CSCO) cases that involve collection information statements (CIS). IRS, *Memorandum For SBSE Directors, Collection Policy And Campus Collection* (Dec. 17, 2015). The deviation affected PPIAs, non-streamlined installment agreements, and CNC determinations. The deviation allowed employees in some cases to disregard the need for taxpayers to substantiate what they reported on the CIS and instead rely on internal verification (unless a discrepancy was identified). This deviation was done to address a backlog of work, not to study ALE standards. The IRS tracked cases in the deviation to ensure that procedures of the deviation were followed. The IRS did not track details of cases, such as how it was resolved or which expenses were allowed a deviation, so TAS is unable to ascertain how this deviation impacted taxpayers. However, the IRS has plans to track cases with an extension of the deviation planned for FY 2017.

42 IRS, *Collection Financial Standards* (March 2016), <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Collection-Financial-Standards>.

43 TAS Research analysis of IRS 2015 ALE Standards and IRS 2016 ALE Standards. Housing costs also decreased in 2,314 counties out of 3,221 counties. *Id.*

44 The Pew Charitable Trusts, *Household Expenditures and Income*, 3 (Mar. 2016).

45 *Id.*

46 Pew Research Center, *Rising Cost of Child Care May Help Explain Recent Increase in Stay-at-Home Moms* (Apr. 8, 2014), <http://www.pewresearch.org/fact-tank/2014/04/08/rising-cost-of-child-care-may-help-explain-increase-in-stay-at-home-moms/>.

47 *Id.*

individual consumer unit. Income, family size, age of family members, geographic location, and individual tastes and preferences all influence expenditures.<sup>48</sup>

The standards are based on inexact projections of the amounts that people spend on a given item. A number of the IRS standards are based on average annual expenditures reported by people who responded to a survey (*e.g.*, the CES). Thus, there is a good chance the taxpayer's expense is greater than what was reported in the survey (or the IRS standards). On the other hand, there is also a similar chance the taxpayer's spending will be less than the survey average. In situations where the taxpayer has an expense greater than the standard, the IRS should be aware that the money to pay this expense will affect the taxpayer's ability to pay expenses in the other categories. Moreover, while some of this greater spending may be a matter of taste and preference, some above-average spending may be necessary to maintain the health and welfare of the household (or for the production of income). In situations where the taxpayer has an expense less than the standard, the taxpayer may need to make greater expenditures for the health and welfare of his household but cannot do so because of limited means.

The IRS also cannot assume that spending habits are consistent over income levels. For instance, while housing costs now account for about 25 percent of a family's pre-tax income, among low income renters, some may spend up to half of their pre-tax income on rent.<sup>49</sup> And while low income families may spend less for transportation costs, what they do spend takes up more of their income. Low income families spent 16 percent of their income on transportation expenses while middle income households spent 11 percent.<sup>50</sup> In this case, the IRS needs to know what expenditures the taxpayer is not making in order to meet their rent obligations.

Low income workers often struggle to make ends meet. It has been noted that achieving this balance each month could be "ephemeral in the event of any increased need or drop in income."<sup>51</sup> Of course, this strain is not felt only by low income families. When income levels are broken into thirds, the typical household in the middle third found its financial slack drop from \$17,000 in 2004 to \$6,000 in 2014.<sup>52</sup> This means that middle income families now have less opportunity to create a cushion for unexpected expenses, bouts with unemployment or long-term illness, or to make long-term savings a reality.

Additionally, the ALE standards are not sensitive to the fact that certain characteristics may make a person more susceptible to falling below the poverty line. For instance, while children represented 23.3 percent of the population in 2014, they compromised 33.3 percent of the people living in poverty.<sup>53</sup> Age and gender interact to create higher poverty rates among women over 65. The poverty rate for women aged 65 and older was 12.1 percent, while the poverty rate for men aged 65 and older was 7.4 percent.<sup>54</sup> The poverty rate for White Americans of non-Hispanic origin was 10.1 percent while the poverty rate among Blacks was 26.2 percent.<sup>55</sup> Professor Mark Rank, of Washington University in St. Louis, has suggested that to understand the scope of poverty in the United States, we ought to consider the risk that each

48 BLS, *CES Frequently Asked Questions*, <http://www.bls.gov/cex/csxfaq.htm#q13>.

49 The Pew Charitable Trusts, *Household Expenditures and Income*, 7 (Mar. 2016).

50 *Id.* at 8.

51 Gregory Acs and Austin Nichols, The Urban Institute, *Working to Make Ends Meet: Understanding the Income and Expenses of America's Low-Income Families*, 30 (Sept. 2005).

52 The Pew Charitable Trusts, *Household Expenditures and Income*, 11 (Mar. 2016). The financial slack of the bottom third actually fell into the negative during the same time period, from \$1,500 in 2004 to negative \$2,300 in 2014.

53 Carmen DeNavas-Walt and Bernadette D. Proctor, U.S. Census Bureau, *Income and Poverty in the United States: 2014*, 14 (Sept. 2015).

54 *Id.* at 15.

55 *Id.* at 14.

American will face poverty at some point during his or her adulthood. He explains, “Just as we have acquired increasing knowledge regarding the likelihood that an individual, for example, may develop heart disease during their lifetime, so too can we ask what is the life course risk of encountering an economic event such as poverty?”<sup>56</sup>

*The ALE Standards Should Be Updated to Include Expenses Necessary to Maintain the Health and Welfare of Households Today, Including an Allocation For Digital Technology Access, Child Care, and Retirement Savings*

A major critique of the current poverty measures has been that the recognized expenses are out of date.<sup>57</sup> When Ms. Orshanksy developed the poverty standards, she recognized the need for updating her method. She remarked, “as yesterday’s luxuries become tomorrow’s necessities, who can define for today how much is enough?”<sup>58</sup> The IRS should follow Ms. Orshanksy’s guidance and update the expenses that are necessary for a basic, healthy standard of living today.<sup>59</sup>

Before the IRS can establish a standard for living expenses, it must understand what amount of money is sufficient for a basic standard of living.

Currently, the IRS treats child care costs as an “other expense,” subject to individual IRS employee judgment, even though it is difficult to imagine a working family getting by without child care expenses.<sup>60</sup> While being treated as an “other expense” does not mean that claims for child care are likely to be denied, it does mean there is no uniform application, or a national or local standard for amount. Other categories of expenses that have become universally accepted for a 21<sup>st</sup> century basic standard of living, such as an allotment for basic digital technology in the household and retirement savings, are not acknowledged at all by the ALE standards or poverty threshold.

The current ALE standards allow for internet services as part of housing and utility costs. However, there is no provision for a computer or other tool to access the internet, such as a tablet.<sup>61</sup> Also, the IRS explicitly does not allow retirement savings as a necessary expense.<sup>62</sup> One survey by the Board of Governors of the Federal Reserve found that 31 percent of non-retired respondents had no retirement savings or pension.<sup>63</sup> This deficit in retirement savings is important to consider because Social Security benefits account for only about 40

56 Mark Rank, *Rethinking the Scope and Impact of Poverty in the United States*, 6 CONN. PUB. INT. L.J. 165, 169 (2007).

57 Diana Pierce and Jennifer Brooks, Wider Opportunities for Women, *The Self-Sufficiency Standard for the Washington, D.C. Metropolitan Area*, 2 (Fall 1999).

58 Mollie Orshanksy, *Counting the Poor: Another Look at the Poverty Profile*, 28 Soc. Sec. Bull. 5 (1965).

59 These adjustments have occurred in non-IRS venues. As mentioned above, Congress has adopted the use of the IRS’s ALE standards in bankruptcy cases. 11 U.S.C. § 707(b)(2)(A)(ii)(I). However, Congress has allowed for additional expenses beyond the ALE standards. Notably, debtors may deduct expenses for protection from family violence and an extra five percent for food and clothing (if the extra expense is necessary). 11 U.S.C. § 707(b)(2)(A)(ii)(I). Debtors may also deduct expenses for care and support of an “elderly, chronically ill, or disabled” family member. 11 U.S.C. § 707(b)(2)(A)(ii)(II). And unlike the ALE standards, debtors may deduct up to \$1,500 per year in educational expenses for a minor. 11 U.S.C. § 707(b)(2)(A)(ii)(IV).

60 IRM 5.15.1.10(3), *Other Expenses* (Nov. 17, 2014).

61 IRM 5.15.1.7(4), *Allowable Expense Overview* (Oct. 2, 2012).

62 IRM 5.15.1.27(2), *Retirement or Profit Sharing Plans* (Nov. 11, 2014).

63 Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014*, 38-39 (May 2015). According to the survey, the rate of retirement savings is tied directly to an individual’s income. Eighty-two percent of the respondents making over \$100,000 per year had at least some retirement savings or pension. Meanwhile, among respondents making under \$40,000 per year, only 42 percent had any retirement savings. *Id.*

percent of retirees' total income, meaning Americans should be funding retirement plans to make up the shortfall.<sup>64</sup>

*Alternative Methods to Measure Household Health and Welfare Provide Better Insight into Necessary Expenses and Establish the Expenses As a Floor Rather Than a Cap*

The current ALE system allows for a consistent approach for analyzing taxpayers' expenses. However, this system does not meet the needs of taxpayers who cannot afford to pay for all of the allowable expenses and it does not take into consideration all necessary expenses. In light of the above information, the IRS needs to consider alternative approaches to determining household health and welfare.

#### FAMILY BUDGETS

Family budgets are a relative measure of what a particular family needs to live modestly in a certain community.<sup>65</sup> The concept differs from the poverty threshold in two ways: it allows for more consumption of goods and services, and it adds the various costs of each budget component without adjusting for income.<sup>66</sup> Applying this concept to the ALE standards would help ensure that all taxpayers have sufficient expenses for a basic standard of living and that each taxpayer receives equitable treatment.

#### THE SELF-SUFFICIENCY STANDARD

Another option to consider is the self-sufficiency standard. Here, the IRS would ask "at what point does a family have sufficient income and resources (such as health benefits) to meet their needs adequately, without public or private assistance?"<sup>67</sup> Unlike the poverty threshold, which is based on the cost of a single item (food) and assumes a fixed ratio, the self-sufficiency standard considers the cost of each item independently, which allows each category to increase at different rates.<sup>68</sup> The self-sufficiency standard also varies by geographic location and includes more modern expenses.<sup>69</sup>

The self-sufficiency standard highlights why the ALE standards need to establish a floor, rather than a cap on expenditures. Since families have unique circumstances, they will incur different expenses. For instance, a family with a handicapped child may have additional expenses related to specialized education or housing needs. The current system, which is based on allowable expenses that are capped, does not acknowledge that taxpayers' lives cover a spectrum of circumstances.

64 See Social Security Administration, <http://www.ssa.gov/policy/docs/ssb/v65n3/v65n3p1.html>; Association for the Advancement of Retired Persons, *Affording Retirement: Social Security Alone Isn't Enough*, [http://www.aarp.org/work/social-security/info\\_06\\_2010/ss\\_isnt\\_enough.html](http://www.aarp.org/work/social-security/info_06_2010/ss_isnt_enough.html).

65 Sylvia Allegretto, *Basic Family Budgets: Working Families' Incomes Often Fail to Meet Living Expenses Around the United States*, 36 INT'L J. OF HEALTH SERV. 3, 444-45 (2006).

66 James Lin and Jared Bernstein, Economic Policy Institute, *What We Need to Get By*, 1 (Oct. 29, 2008).

67 Diana Pierce and Jennifer Brooks, Wider Opportunities for Women, *The Self-Sufficiency Standard for the Washington, D.C. Metropolitan Area*, 3 (Fall 1999).

68 *Id.*

69 University of Washington Center for Women's Welfare, *Measuring Poverty*, <http://selfsufficiencystandard.org/node/91>.

## CONCLUSION

Congress intended that taxpayers be allowed a sufficient amount of living expenses to provide for the health and welfare of their households and for the provision of income, prior to resolving IRS liabilities. The current ALE standards do not fulfill this intent. The current standards are based on outdated measurements and assumptions and are implemented in a way that keeps some taxpayers in poverty or reduced circumstances in order to meet their taxpaying obligations.

Taxpayers have a responsibility to pay their taxes. However, this responsibility should not come at the cost of not being able to afford basic living expenses. When something like the situation in *Leago* occurs, it is proof that the current standards do not take into account the taxpayer's specific facts and circumstances, clearly violating the taxpayer's *right to a fair and just tax system*.

To meet the intent of Congress, the IRS needs to reevaluate how it develops and uses the ALE standards. Before the IRS can start that process, however, it must understand what it costs to maintain the health and welfare of a household in the 21<sup>st</sup> century. The costs must be updated to include such things as child care, technology, and retirement savings. Furthermore, the standards must reflect the minimum amount necessary to maintain the health and welfare of a household, not the maximum. In doing so, the IRS will ensure that every taxpayer is allowed sufficient expenses for maintaining the health and welfare of his or her household while meeting his or her tax-paying obligations.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In conjunction with TAS, consider the family budget or self-sufficiency standard as an alternative method to calculate the cost of providing for the health and welfare of households. The alternative method should not be a cap to allowable expenses, but should represent the floor for what can be claimed.
2. Expand the standard to include additional expenses for basic technology in the household, child care, and retirement savings.
3. Reconsider the recent decrease in ALE standards for national standards, out-of-pocket healthcare, housing, and transportation.

**MSP  
#14****APPEALS: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values****RESPONSIBLE OFFICIAL**

Donna C. Hansberry, Chief, Appeals

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

An independent and effective Office of Appeals (Appeals) within the IRS is essential for quality tax administration and meaningful protection of taxpayer rights. Appeals' mission is to resolve tax controversies on a basis that is fair and impartial to both the government and the taxpayer and in a manner that will enhance public confidence in the integrity and efficiency of the IRS.<sup>2</sup> To the extent that Appeals achieves these goals, the result will be an increase in timely and efficient resolution of disputes between taxpayers and the IRS, a heightened level of trust on the part of taxpayers, and an expansion of overall taxpayer compliance.<sup>3</sup>

Recently, Appeals has faced significant resource constraints. For example, Appeals' funding has fallen by approximately 11.2 percent, from \$221.1 million in fiscal year (FY) 2013 to \$196.4 million in FY 2016.<sup>4</sup> Further, the number of Appeals Hearing Officers (Hearing Officers) has been reduced by approximately 24 percent between FY 2013 and FY 2016.<sup>5</sup>

<sup>1</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

<sup>2</sup> Internal Revenue Manual (IRM) 8.1.1.1(1), *Accomplishing the Appeals Mission* (Feb. 10, 2012).

<sup>3</sup> See, e.g., S. REP. No. 105-174, at 84 (1998); Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia's Tax Disputes Resolution Procedures*, 27 AUSTL. TAX F. 525, 528-29 (2012); Erich Kirchler, *THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOR* (2007); Tom R. Tyler, *WHY PEOPLE OBEY THE LAW* (2006).

<sup>4</sup> IRS, *Appeals Business Performance Review (BPR), Fourth Quarter FY16*, 24 (Nov. 7, 2016), <http://appeals.web.irs.gov/stratplan/documents/Appeals-BPR-Q4-2016.doc>, IRS, *Appeals Business Performance Review (BPR), Fourth Quarter FY13*, 24 (Nov. 7, 2013), <http://appeals.web.irs.gov/stratplan/documents/Appeals-BPR-Q4-2013.doc>.

<sup>5</sup> Appeals response to TAS supplemental information request (Oct. 28, 2016). The term "Hearing Officer" refers to any Settlement Officer, Hearing Officer, Appeals Account Resolution Specialist, or other employee holding hearings, conferences or who otherwise resolves open case issues in Appeals. It further encompasses individuals who conduct or review administrative hearings or who supervise Hearing Officers. See IRS, *AJAC FAQs*, <http://appeals.web.irs.gov/about/ajac-faq.htm> (updated July 7, 2014).



Appeals has responded to these limitations by implementing policies and procedures, some of which create hardships for taxpayers and detract from Appeals' long-term mission. The National Taxpayer Advocate has expressed concerns regarding a number of approaches adopted by Appeals, including:

- Fostering an inhospitable Appeals environment;<sup>6</sup>
- Limiting taxpayers' right to an in-person conference;<sup>7</sup>
- Reducing the quality of substantive reviews under the Appeals Judicial Approach and Culture (AJAC) project;<sup>8</sup> and
- Failing to sufficiently protect the rights of taxpayers when conducting Collection Due Process (CDP) appeals and Collection Appeals Program (CAP) hearings.<sup>9</sup>

Appeals' proposed trajectory, which would either exacerbate or ignore many of these concerns, is set forth in its preliminary design for a future vision. This Concept of Operations (CONOPS) is a guiding set of principles that serves as a roadmap for where Appeals would like to be in the next five years.<sup>10</sup> To date, however, Appeals' CONOPS is limited by its reliance on a "one size fits all" model that is primarily bureaucratic- and enforcement-oriented. By contrast, the National Taxpayer Advocate urges Appeals to embrace a future vision premised on a collaborative model of taxation that would more successfully engage taxpayers as participants in the voluntary tax system.

## ANALYSIS OF PROBLEM

### Appeals' CONOPS Is Partially Driven by Declining Operating Budgets in Recent Years

Reductions in funding and additional demands to demonstrate return on investment have put pressure on the IRS, including Appeals, to increase revenues and lower costs.<sup>11</sup> The number of Appeals cases has dropped slightly, but then stabilized over the last few years. During that time, however, the number of Hearing Officers has sharply declined. These trends can be seen in the following figure:

**FIGURE 1.14.1, Appeals Workload by Fiscal Year<sup>12</sup>**

| Fiscal Year | Case Receipts Settlements | Hearing Officers |
|-------------|---------------------------|------------------|
| FY 2013     | 123,113                   | 924              |
| FY 2014     | 113,608                   | 852              |
| FY 2015     | 113,870                   | 768              |
| FY 2016     | 114,362                   | 705              |

6 National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

7 National Taxpayer Advocate 2014 Annual Report to Congress 46-54.

8 National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

9 National Taxpayer Advocate 2014 Annual Report to Congress 185-96; National Taxpayer Advocate 2015 Annual Report to Congress 91-99.

10 IRS, *Appeals Business Performance Review (BPR), Fourth Quarter FY15*, 2 (Nov. 16, 2015), <http://appeals.web.irs.gov/stratplan/documents/Appeals-BPR-Q4-2015.doc>. Subsequently, Appeals has renamed this initiative "Appeals' Future State." The term CONOPS, however, will be retained herein for the sake of brevity.

11 IRS, *Office of Appeals Concept of Operations (CONOPS)*, 4 (Aug. 31, 2015) (on file in TAS archives).

12 Data for this figure was drawn from the Appeals response to TAS supplemental information request (Oct. 28, 2016).

During this same period, however, the percentage of Examination-based Appeals cases that are docketed in the United States Tax Court (known as “docketed Appeals cases”) has increased in comparison to non-docketed Appeals cases.<sup>13</sup> This increase of approximately 12 percent, which is shown below, may mean that taxpayers’ procedural rights to an appeal are being abridged, or that they are growing increasingly impatient regarding the timeliness of reviews available via the standard administrative process.<sup>14</sup> This explanation could account for why an increasing percentage of taxpayers are finding it necessary to take their cases to courts, which, in turn, send the cases back for Appeals’ consideration, a circumstance causing both delay and expense for taxpayers and the IRS.

**FIGURE 1.14.2, Non-Docketed Versus Docketed Appeals Cases by Fiscal Year**

| Fiscal Year | Non-Docketed Case Receipts | Docketed Case Receipts | Non-Docketed Percentage | Docketed Percentage |
|-------------|----------------------------|------------------------|-------------------------|---------------------|
| FY 2013     | 33,101                     | 23,577                 | 58%                     | 42%                 |
| FY 2014     | 28,144                     | 24,703                 | 53%                     | 47%                 |
| FY 2015     | 26,009                     | 25,203                 | 51%                     | 49%                 |
| FY 2016     | 26,421                     | 23,812                 | 53%                     | 47%                 |

Over time, the number of Hearing Officers has decreased significantly more than the amount of work they are required to perform. This need to do more with less presents challenging issues that underlie Appeals’ CONOPS, and the National Taxpayer Advocate understands Appeals’ concerns regarding resources. Appeals’ need for operational efficiency and cost-effectiveness, however, is not, in the long run, best served by such steps as limiting access to in-person or geographically proximate conferences, or reducing the quality of substantive review. Rather, taxpayers who choose to engage in dialogue with the IRS through participation in the Appeals process should be encouraged, educated, and welcomed as partners in the voluntary tax system.

### **Appeals’ CONOPS Does Not Yet Address Many of the Core Taxpayer Service Issues Currently Existing Within Appeals**

Appeals’ CONOPS is inevitably impacted by the resource challenges to which Appeals is currently subject. Nevertheless, CONOPS also presents an exceptional opportunity to improve the taxpayer experience within Appeals. To date, however, Appeals’ CONOPS is primarily amorphous and aspirational.<sup>15</sup> It begins with an examination of Appeals’ current state, based on which Appeals identifies six challenges and associated changes that will inform its future vision. These issues relate to inefficient

13 Examination-based cases represent the best data set for observing trends in this context, as Collection-based cases overwhelmingly give rise to nondocketed appeals (approximately 99.9%). Appeals response to TAS supplemental information request (Oct. 28, 2016). If taxpayers file a valid petition for review in the U.S. Tax Court, the case often is referred back to Appeals for possible settlement if they have not previously had an opportunity to present their case to Appeals. See IRM 8.4.1.4(1), *Appeals Authority Over Docketed Cases*, (Oct. 26, 2016).

14 This increase of approximately 12 percent is based on data provided by Appeals in its response to TAS supplemental information request (Oct. 28, 2016). The percentages shown in the following table are calculated through dividing the non-docketed and docketed case receipts, respectively, by total case receipts, shown in Figure 1 above.

15 In response to an information request, Appeals provided TAS with an Aug. 31, 2015 document discussing Appeals’ CONOPS. According to Appeals, all subsequent materials are in internal pre-decisional phases and are not yet available for release. Appeals’ response to TAS information request (June 6, 2016). Given the period of time elapsed, it is somewhat difficult to tell whether Appeals has created additional Future State documents that it is affirmatively withholding pending an ongoing pre-decisional process, or whether there simply has been little-to-no progress on Appeals’ Future State (other than the name change) since the August 31, 2015 draft, which TAS was provided.

resolution pathways sometimes chosen by taxpayers, workload predictability, technology, Appeals workforce skillsets, attrition, and case management.<sup>16</sup>

Appeals' CONOPS then briefly articulates the principles, features, and initiatives intended to address these challenges. To this point, Appeals' CONOPS deals primarily in broad generalities and provides few specifics. It alludes to a tailored Appeals path in which cases would receive a particular treatment based on the issue or taxpayer type.<sup>17</sup> It also briefly discusses transparent and consistent communications with taxpayers regarding the Appeals process.<sup>18</sup> Nevertheless, Appeals' CONOPS does not yet furnish a detailed plan for achieving these or any other goals.

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**Taxpayers who choose to engage in dialogue with the IRS through participation in the Appeals process should be encouraged, educated, and welcomed as partners in the voluntary tax system.**

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The pathway outlined by Appeals' CONOPS is too indistinct to allow for in-depth analysis. However, some of its features, such as those that contemplate accepting only cases that have an "actual disagreement" and adopting a process that provides taxpayers with only "one opportunity to settle their case in Appeals" are concerning in that they could exacerbate the problems already created by the manner in which AJAC has been implemented.<sup>19</sup> Also, Appeals' CONOPS's idea of making alternative dispute resolution (ADR) available earlier in the tax controversy process is encouraging, but if it is not combined with a more systemic revision of the IRS's overall ADR program, it likely will continue to receive only tepid interest and minimal use.<sup>20</sup>

From a broader, more fundamental perspective, Appeals' CONOPS appears to be focused primarily on internal Appeals logistics, such as technology, training, career paths, case management, and communications, all of which are worthy candidates for systemic enhancement. Nevertheless, to be truly significant and effective, Appeals' CONOPS should center on the taxpayer experience and seek to improve the case resolution environment via engagement with the taxpayer.

### **TAS Urges Appeals to Adopt a Future Vision That Is More Collaborative and Taxpayer Friendly**

To the extent that Appeals is willing to expand the current focus of CONOPS beyond primarily internal issues, Appeals has the opportunity to establish a more welcoming environment for taxpayers and to facilitate streamlined case resolutions. For example, taxpayers and tax practitioners often feel that a live meeting with a Hearing Officer is an important element in the proper presentation and clear understanding of their case.<sup>21</sup> Moreover, an in-person meeting can sometimes be crucial for the accurate communication of ideas and can assist Hearing Officers in gauging credibility and assessing the strength of the taxpayer's case.<sup>22</sup> The absence of in-person conferences "... puts taxpayers and their representatives

<sup>16</sup> IRS, *Office of Appeals Concept of Operations (CONOPS)*, 8 (Aug. 31, 2015) (on file in TAS archives).

<sup>17</sup> *Id.* at 12.

<sup>18</sup> *Id.* at 15.

<sup>19</sup> *Id.* at 12. Among other things, TAS's concern regarding these reasonable-sounding goals is that they could be code words for further decreasing substantive reviews and increasing case transfers to Compliance. See discussion *infra*. See also National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

<sup>20</sup> IRS, *Office of Appeals Concept of Operations (CONOPS)*, 15 (Aug. 31, 2015) (on file in TAS archives). For a more in-depth discussion of ADR and how it might be expanded by the IRS, see Most Serious Problem: *Alternative Dispute Resolution (ADR): The IRS is Failing to Effectively Utilize ADR as a Means of Achieving Mutually Beneficial Outcomes for Taxpayers and the Government*, *infra*.

<sup>21</sup> TAS conference call with practitioners associated with the American Bar Association (ABA) Tax Section (Apr. 28, 2016).

<sup>22</sup> *Id.*

at a great disadvantage,” and “... substantially increases professional fees and extends the timeline in which to resolve cases.”<sup>23</sup>

Appeals, however, has expanded the number of states without any Hearing Officers possessing case responsibilities by 33 percent (from nine to 12) between 2011 and the present.<sup>24</sup> Although taxpayers living in these states without an Appeals presence, or in portions of other states not located near an Appeals office, may still be able to obtain an in-person conference, they generally are left with the option of waiting until a Hearing Officer “rides circuit” in their area, or traveling sometimes substantial distances and incurring significant costs to obtain their desired meeting.

Further, Appeals has taken affirmative steps to clarify that in-person conferences are a matter of discretion for the Hearing Officer, not a matter of right for the taxpayer, and will be considered only under specific circumstances.<sup>25</sup> “By putting in place business rules around when Appeals provides in-person conferences, the changes shift the decision from the taxpayer to Appeals.”<sup>26</sup> Several taxpayer representative groups have expressed objections that this approach may decrease the fairness and ultimate number of case resolutions reached in Appeals.<sup>27</sup> Moreover, the issue of how this new policy will be applied in the case of CDP appeals remains an open and troubling question.<sup>28</sup>

The National Taxpayer Advocate raised concerns about these policies to Appeals leadership in a Spring 2016 meeting.<sup>29</sup> Appeals justified the move away from in-person conferences by explaining that:<sup>30</sup>

- Approximately 59 percent of taxpayers requesting an in-person conference, which has the effect of shifting a case from Campus Appeals to Field Appeals, do not ultimately hold the requested conference;
- Field-based Hearing Officers complain that, because of these in-person conference requests, they are asked to handle lower-graded cases, such as those relating to the Earned Income Tax Credit (EITC) and itemized deductions;
- Field-based Hearing Officers assigned to cases involving in-person conferences often are not experts in the applicable subject matter; and
- Campus facilities are not designed to accommodate in-person conferences, while Field appeals (which is where such cases are transferred) are substantially more expensive to conduct.

23 Dave R. Stubblefield, Michael D. Williams, CPA, Kenneth M. Horwitz, JD, *Growing Concerns of Appeals’ Face-to-Face Meetings*, Texas Society of Certified Public Accountants (Jan. 25, 2016), <http://tscpafederal.typepad.com/blog/2016/01/growing-concerns-of-appeals-face-to-face-meetings.html>. See also Letter from Texas Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (May 13, 2016) (on file in TAS archives).

24 These states are comprised of Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont, and Wyoming. The territory of Puerto Rico also lacks a permanent Appeals office. Appeals response to TAS information request (June 6, 2016). See also National Taxpayer Advocate 2014 Annual Report to Congress 46.

25 IRM 8.6.1.4.1, *Conference Practice* (Oct 1, 2016).

26 Open letter from Kirsten Wielobob, Chief, Appeals (Nov. 16, 2016).

27 See Letter from American College of Tax Counsel to Kirsten Wielobob, Chief, Appeals (Oct. 10, 2016) (on file in TAS archives); Leslie Book, *Technology and the Tax System: A Less Personal Appeals Office Coming Our Way*, *PROCEDURALLY TAXING* (Oct. 13, 2016), <http://procedurallytaxing.com/technology-and-the-tax-system-a-less-personal-appeals-office-coming-our-way/>. Letter from Texas Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (May 13, 2016) (on file in TAS archives). The ABA Tax Administrative Practice Committee also has an ongoing comment project regarding changes to Appeals processes with respect to in-person appeals. Email from ABA Tax Administrative Practice Committee (Oct. 12, 2016) (on file in TAS archives).

28 IRM 8.22.4.1(2), *Collection Due Process (CDP) Technical IRM Overview* (Mar. 29, 2016).

29 Notes from meeting between the National Taxpayer Advocate and Appeals Executives (May 31, 2016) (on file with TAS).

30 *Id.*

In response, the National Taxpayer Advocate pointed out that many of the requests for in-person conferences likely result from an attempt by taxpayers to obtain a Hearing Officer with knowledge of the local economy, which is a reasonable and appropriate desire that should be accommodated.<sup>31</sup> To facilitate this local presence and these in-person conferences, Appeals should expand its geographic footprint by strategically moving some Hearing Officers out of campuses and back to permanent postings in states where Appeals is underrepresented, or in many cases, unrepresented.

In answer to the complaints of Field-based Hearing Officers about working lower-graded cases, the National Taxpayer Advocate explained that EITC issues are as complicated as many transactions, are intensely factual, and are often based on the credibility of witnesses.<sup>32</sup> Care must be taken not to use CONOPS as a means of disproportionately and unfairly forcing EITC cases, and those of other low-income taxpayers, to campuses. The National Taxpayer Advocate suggested to Appeals leadership that they consider re-grading certain cases and blending higher-graded and lower-graded Hearing Officers within Campus and Field Appeals. This approach would allow a better matching of appropriately graded cases to particular Hearing Officers. It would also more strategically tailor the expertise of particular Hearing Officers to the substantive knowledge requirements of individual cases. Likewise, necessary expertise can be added on a consulting basis, which would have the further benefit of helping Hearing Officers expand their skillsets.<sup>33</sup>

Appeals' concerns regarding the additional expense of Field Appeals and the large percentage of cases in which requested in-person conferences are not ultimately held are reasonable. The best solution, however, for taxpayers and Appeals is to increase the trust of taxpayers in the quality of Campus appeals. Further, as previously recommended by the National Taxpayer Advocate, the IRS in general, and Appeals in particular, should continue to expand its implementation of Virtual Service Delivery.<sup>34</sup> Increased confidence in Campus appeals, as well as widespread availability of virtual face-to-face conferences, likely would reduce the number of requests for in-person conferences, would keep more cases in the campuses, and would be more cost-effective for Appeals. This increased trust would also have the less tangible, but no less real benefit, of improving the experience that many taxpayers have with Appeals.

A more flexible and taxpayer-friendly approach can be an excellent means of moving the Appeals process toward a collaborative, conversational model, rather than one that, under AJAC, has lately been driven too much by rigid procedures and tight timelines. Appeals has increasingly been pushing taxpayers to "fully cooperate" with Compliance demands, even where those demands may be the subject of good faith disagreement, an approach that is coercive rather than collaborative.<sup>35</sup>

Last year, the National Taxpayer Advocate published a Most Serious Problem analyzing AJAC and making a number of recommendations, including that AJAC restrictions be loosened to provide Hearing Officers with more discretion in the resolution of cases.<sup>36</sup> The IRS responded that Hearing Officers already have discretion to determine whether additional factual development or analysis is needed, at which point cases are sent back to Compliance for additional investigation.<sup>37</sup> Nevertheless, under AJAC policy and practice, Hearing Officers are provided with minimal ability to determine when even modest factual investigation

31 Notes from meeting between the National Taxpayer Advocate and Appeals Executives (May 31, 2016) (on file with TAS).

32 *Id.* See IRC § 32.

33 Notes from meeting between the National Taxpayer Advocate and Appeals Executives (May 31, 2016).

34 National Taxpayer Advocate 2014 Annual Report to Congress 154-62.

35 IRS, *Fact Sheet—IRS Clarifies Office of Appeals Policies* (Oct. 1, 2016), [www.irs.gov/PUP/individuals/factsheet.pdf](http://www.irs.gov/PUP/individuals/factsheet.pdf).

36 National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

37 National Taxpayer Advocate 2017 Objectives Report to Congress 80-84.

or verification can be done in Appeals. Additional authority and flexibility for Hearing Officers to determine when their own case development could assist case resolution would decrease delay and expense for both taxpayers and the government.

This trend by Appeals of relying on internal IRS procedures as a means of bypassing meritorious arguments of taxpayers and avoiding substantive issues raised by taxpayers or TAS is one that should be reversed by a broader change in Appeals' culture that can start with CONOPS. Appeals' CONOPS should move beyond its present focus on internal processes and be expanded with the goals of improving the taxpayer experience, relying on a collaborative process, and perpetuating a culture of protecting taxpayers and working with taxpayers and TAS to resolve issues.

This more taxpayer-friendly approach would be especially welcome in the Collection context, which perhaps represents Appeals' greatest opportunity and responsibility with respect to taxpayers and the tax system. Toward that end, Appeals should revitalize CAP by allowing Hearing Officers to consider collection alternatives as part of their deliberations and then remand cases to Compliance for further action. Additionally, Appeals should rigorously apply the balancing test to CDP appeals as a means of ensuring that Collection actions are reasonable and are no more intrusive than necessary. Most taxpayers contesting Collection actions, as with those filing Examination-based appeals, wish to be compliant and would welcome the facilitation of Appeals in considering and implementing appropriate case resolutions.

## CONCLUSION

The National Taxpayer Advocate and external stakeholders have recently expressed concerns regarding a range of Appeals' programs and policies. These concerns, however, are left unaddressed by Appeals' CONOPS, which sets forth Appeals' projected roadmap over the next five years. To this point, Appeals' CONOPS is so vague and aspirational as to prevent meaningful analysis. It appears, however, to contemplate primarily bureaucratic initiatives and hints at procedural changes that would ignore or exacerbate the problems already existing within Appeals. This limited focus may help clear dockets in the short run, but runs the risk of disadvantaging taxpayers, jeopardizing tax compliance, and increasing the resources needed for tax enforcement in the long run.

Appeals should use the opportunity presented by CONOPS to embrace a future vision premised on working collaboratively with taxpayers to achieve mutually acceptable negotiated settlements. As part of this more taxpayer-friendly process, Appeals should enhance taxpayer trust and dialogue by making in-person conferences available where they are requested in good faith, being mindful of the prevailing geographic and local contexts out of which tax cases arise, and allowing taxpayers access to Hearing Officers with relevant subject matter expertise. Further, Hearing Officers should be provided with the time, authority, and flexibility needed to fully develop cases and to explore potential outcomes with taxpayers. TAS urges an Appeals Future State that recognizes the desire of most taxpayers to be compliant and that is designed to work with them in furtherance of this goal.



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt an Appeals future vision in which Appeals adopts policies and organizes itself in a way that makes in-person Appeals conferences readily available to good-faith taxpayers who request a live conference as part of the case resolution process.
2. Adopt an Appeals future vision in which Appeals expands its geographic footprint and strategically reallocates Campus-based and Field-based Hearing Officers to increase the confidence of taxpayers that they will have access to Hearing Officers with requisite local knowledge and substantive expertise, regardless of the assigned location.
3. Adopt an Appeals future vision in which Appeals revises its procedures to allow Hearing Officers additional discretion and time to personally undertake factual development and provide more in-depth substantive review in seeking fair and efficient resolutions of Examination-based and Collection-based Appeals cases.

**MSP  
#15****ALTERNATIVE DISPUTE RESOLUTION (ADR): The IRS Is Failing to Effectively Use ADR As a Means of Achieving Mutually Beneficial Outcomes for Taxpayers and the Government****RESPONSIBLE OFFICIALS**

Donna C. Hansberry, Chief, Appeals  
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Douglas W. O'Donnell, Commissioner, Large Business and International Division  
 Sunita Lough, Commissioner, Tax Exempt and Government Entities Division  
 Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM<sup>2</sup>**

Alternative dispute resolution (ADR) is the process of resolving a dispute through non-judicial means, typically by placing the case in non-binding mediation or in binding arbitration.<sup>3</sup> These proceedings are generally conducted by neutral parties, such as mediators, administrative law judges (ALJs), or ombudsmen. Researchers, commentators, and stakeholders have published substantial in-depth analysis regarding the effectiveness and flexibility of ADR in a variety of contexts. Further, studies in this area demonstrate that efficient ADR can have a beneficial impact on tax compliance and tax administration.<sup>4</sup>

The IRS itself has acknowledged that ADR can play a useful role within its operations. “A primary objective of the [IRS] is to resolve tax controversies at the lowest level without sacrificing the quality and integrity of those determinations. [ADR], or mediation programs achieve this objective.”<sup>5</sup> Additionally, the IRS has expressed the view that at least some aspects of ADR can successfully be used “[t]o promote issue resolution at earlier stages and decrease the overall time from return filing to ultimate issue resolution.”<sup>6</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Options for Alternative Dispute Resolution (ADR)*, vol. 3, *infra*.

3 Throughout this Most Serious Problem, alternative dispute resolution (ADR) will be used as a collective term referring both to mediation and arbitration. More specific terms will be adopted where distinctions among the various forms of ADR become relevant.

4 See, e.g., Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia's Tax Disputes Resolution Procedures*, 27 AUSTL. TAX F. 525 (2012); Amy S. Wei, *Can Mediation Be the Answer to Taxpayers' Woes?: An Examination of the Internal Revenue Service's Mediation Program*, 15 OHIO ST. J. ON DISP. RESOL. 549, 549 (2000).

5 Internal Revenue Manual (IRM) 8.26.3.1(1), *Objective and Authority for Fast Track Mediation (FTM)* (Dec. 5, 2014).

6 Rev. Proc. 2003-40, 2003-25 I.R.B. 1044.

Nevertheless, the IRS is underutilizing this potentially valuable tool and is administering ADR in a way that is unattractive to taxpayers. For example, taxpayers and their representatives could reasonably question the accessibility, cost effectiveness, and impartiality of ADR proceedings.<sup>7</sup> These doubts likely help to explain why during fiscal year (FY) 2016, the IRS reported only 306 ADR case receipts—less than one-half of one percent of the total Appeals case receipts for the year.<sup>8</sup>

ADR, if thoughtfully and creatively implemented, could substantially increase the efficiency and timeliness of case resolutions. In turn, an effective ADR program would protect taxpayer rights, reduce taxpayer burden and cost, encourage voluntary compliance, and economize scarce IRS resources. The IRS can take important initial steps toward building ADR into a highly useful mechanism for administrative dispute resolution by remedying existing problems, such as:

- The narrow scope of ADR, which excludes a wide range of cases, including controversies flowing from most Campus Collection actions;
- The effective veto power possessed by the IRS over all potential ADR proceedings; and
- The practice of staffing ADR programs with Appeals Officers, who may not be perceived by taxpayers as neutral parties.

## ANALYSIS OF PROBLEM

### The IRS Could Benefit Substantially From ADR Lessons Learned From Commentators, Businesses, Various Federal Agencies, and Tax Authorities of Certain Foreign Countries

ADR finds longstanding precedent throughout history, including application among Phoenician merchants, use by Alexander the Great's father, and inclusion in George Washington's will.<sup>9</sup> Specifically, "... ADR techniques can be placed on a continuum, ranging from left to right in complexity from simple two-party negotiations to mediation to binding arbitration, with an unlimited number of hybrid techniques in between."<sup>10</sup>

The private sector has been quick to understand and seek the benefits of ADR, particularly arbitration. According to the RAND Institute for Civil Justice (RAND), some studies have indicated that over 70 percent of consumer contracts possess arbitration clauses.<sup>11</sup> Likewise, the majority of corporate counsels

7 IRS personnel generally serve as the "neutral" party in ADR proceedings. See e.g. IRM 8.26.3.1(2), *Objective and Authority for Fast Track Mediation (FTM)* (Dec. 5, 2014).

8 Fiscal year (FY) 2016 data provided by Appeals (Oct. 19, 2016).

9 Ji Hun Kim and Nicholas M. McGrath, *Mediation: Can't We All Just Get Along?*, 30 Sept. AM. BANKR. INST. 52, 52 (2011); R. Jeff Knight, *Alternative Dispute Resolution in Tax Cases* (Jan. 23, 2013), <http://ccintranet.prod.irs.counsel.treas.gov/OrgStrat/Offices/sbse/Presentation%20Materials>; A.B.A., Sec. of Disp. Resol., *Benefits of Arbitration for Commercial Disputes*, [http://www.americanbar.org/content/dam/aba/events/dispute\\_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/events/dispute_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf) (last visited Mar. 8, 2016).

10 Steven C. Wrappe, *Advance Pricing Agreements: The IRS Rediscovered Alternative Dispute Resolution*, 63 TAX NOTES 1343, 1345 (June 6, 1994).

11 Douglas Shontz, Fred Kipperman, and Vanessa Soma, RAND Inst. For Civ. Just., *Business-to-Business Arbitration in the United States: Perceptions of Corporate Counsel*, 2 (2011). See also Mandy Walker, *The Arbitration Clauses Hidden in Many Consumer Contracts*, CONSUMER REPORTS (Sep. 29, 2015), <http://www.consumerreports.org/cro/shopping/the-arbitration-clause-hidden-in-many-consumer-contracts>.

surveyed by RAND believe that contractual arbitration is better, faster, and cheaper than litigation.<sup>12</sup> Moreover, according to studies cited by the American Bar Association Section of Dispute Resolution:

- 80 percent of attorneys and 83 percent of business people report that arbitration is a fair and just process;
- 86 percent of corporate counsels are satisfied with international arbitration; and
- Over 90 percent of parties involved in arbitration voluntarily comply with the outcome.<sup>13</sup>

Likewise, some federal agencies, such as the Environmental Protection Agency (EPA), the United States Air Force (Air Force), and the Social Security Administration (SSA) have used ADR to great advantage. For example, issues resolved via ADR within the EPA demand less than 50 percent of the time from staff leads than would be required in more contentious traditional proceedings.<sup>14</sup> Eighty-seven percent of the staff leads surveyed by the EPA with respect to their particular cases believed that ADR “was a good investment for EPA.”<sup>15</sup>

The Air Force reports that large disputes that took an average of five years to resolve through litigation are now being resolved by the use of ADR in an average of just over 12 months.<sup>16</sup> According to the Air Force, it has avoided paying over \$275 million in contractor claims since the “ADR First” policy was instituted in 2000.<sup>17</sup>

Where SSA is concerned, ADR is conducted by ALJs who are provided free of charge and who are housed in a wholly independent unit from other SSA groups. Of the approximately 700,000 ALJ decisions rendered each year, only approximately 16,000 (less than 3 percent) are appealed to federal courts.<sup>18</sup>

Recognizing the benefits of ADR, the tax authorities of several foreign countries have also sought to institute a range of ADR programs. For example, Hong Kong utilizes an appeals system incorporating aspects of binding arbitration in which taxpayers can bring cases before a Board of Review comprised of a chairman with legal training and at least two members with expertise in other professions.<sup>19</sup> In Australia, the government and taxpayers are encouraged to pursue ADR by a legal requirement that

12 Douglas Shontz, Fred Kipperman, and Vanessa Soma, RAND Inst. For Civ. Just., *Business-to-Business Arbitration in the United States: Perceptions of Corporate Counsel*, ix (2011).

13 A.B.A., Sec. of Disp. Resol., *Benefits of Arbitration for Commercial Disputes*, [http://www.americanbar.org/content/dam/aba/events/dispute\\_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/events/dispute_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf) (last visited Mar. 8, 2016).

14 Conflict Prevention and Resol. Ctr., U.S. Envtl. Protection Agency, *FY 2014 Environmental Collaboration and Conflict Resolution (ECCR) Policy Report to OMB-CEQ*, 18-19 (Feb. 17, 2015).

15 *Id.* at 19-20.

16 Off. of the Att’y Gen., *Report for the President on the Use and Results of Alternative Dispute Resolution in the Executive Branch of the Federal Government*, 155 (Apr. 2007).

17 The Air Force ADR Program, *Report to the Secretary of the Air Force on the Air Force Alternative Dispute Resolution Program*, 1 (Dec. 2012).

18 *Information About SSA’s Office of Disability Adjudication and Review*, [https://www.ssa.gov/appeals/about\\_odar.html](https://www.ssa.gov/appeals/about_odar.html) (last visited Mar. 16, 2016). Note that SSA has been criticized for the backlog of cases awaiting administrative law judge (ALJ) hearings and at least one Congressional committee has questioned whether ALJs allow too many claims in order to clear dockets quickly. These caseload issues, however, do not appear inherent to Social Security Administration’s (SSA) ADR design, but rather to ALJ understaffing and documentation requirements. See *generally* *Systemic Waste and Abuse at the Social Security Administration: How Rubber-Stamping Disability Judges Cost Hundreds of Billions of Taxpayer Dollars: Hearing Before the H. Comm. on Oversight and Govt. Reform*, 114th Cong. (2014). David Fahrenthold, *The Biggest Backlog in the Federal Government*, WASH. POST, Oct. 18, 2014, <http://www.washingtonpost.com/sf/national/2014/10/18/the-biggest-backlog-in-the-federal-government/>.

19 *Tax Dispute Resolution: A New Chapter Emerges, Tax Administration Without Borders*, Ernst & Young, 2010; *Tax Disputes: Alternative Dispute Resolution (ADR), Functions and Procedures*, Board of Review (Inland Revenue Ordinance) (Mar. 15, 2016), [www.info.gov.hk/bor/en/functions-procedures.htm](http://www.info.gov.hk/bor/en/functions-procedures.htm) (on file in TAS archives).

Alternative Dispute Resolution (ADR), if thoughtfully and creatively implemented, could substantially increase the efficiency and timeliness of case resolutions. In turn, an effective ADR program would protect taxpayer rights, reduce taxpayer burden and cost, encourage voluntary compliance, and economize scarce IRS resources.

they file a “genuine steps” statement outlining the attempts they made to avoid litigation before court proceedings can begin.<sup>20</sup> Although relatively new, Australia’s ADR procedures appear to be producing good results in achieving resolutions more frequently and earlier in the objection and appeals process.<sup>21</sup> Likewise, ADR implemented by Her Majesty’s Revenue and Customs (HMRC) in the United Kingdom seems to be working well, with some data suggesting that ADR resolutions can be achieved approximately seven times faster than litigation decisions.<sup>22</sup> Further, the HMRC’s 2013 ADR Project Evaluation Report indicates that 58 percent of all cases selected for ADR were fully resolved, while a further eight percent were partially resolved.<sup>23</sup>

### A Quality ADR Program Can Be an Important Contributor to Successful Tax Administration

When implemented effectively, ADR can have a particularly salutary effect on tax compliance and the voluntary tax system.<sup>24</sup> Its flexibility and participatory nature increase perceptions of equity and procedural justice.<sup>25</sup> In turn, such perceptions can positively impact tax compliance behavior in the future.<sup>26</sup>

Specifically, “the tax compliance literature identifies that factors associated with tax disputes resolution procedures can influence taxpayers’ level of compliance.”<sup>27</sup> Of the various factors influencing tax compliance behavior, quality of contact with the tax authorities and taxpayers’ perceptions of fairness are particularly strengthened or diminished by an effective ADR program.<sup>28</sup> Generally, people who feel they have been treated in a procedurally fair manner by an organization are more likely to trust that organization and are more willing to accept even a negative outcome.<sup>29</sup> Further, “people value respectful treatment by authorities and view those authorities that treat them with respect as more entitled to be obeyed.”<sup>30</sup> ADR done well can help generate the types of interactions and perceptions that will perpetuate the compliant behavior necessary to the success of the voluntary tax system.

20 *Tax Disputes and Controversy Update—Focus on Alternative Dispute Resolution*, KPMG, (Aug. 5, 2014), <https://home.kpmg.com/xx/en/home/insights/2014/08/focus-on-alternative-dispute-resolution.html>.

21 *Id.*

22 Hui Ling McCarthy, *Tribunal Fees—A Tax on Justice*, (Jan. 1, 2016), <http://www.taxadvisermagazine.com/article/tribunal-fees-%E2%80%93-tax-justice>.

23 *Id.*

24 Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia’s Tax Disputes Resolution Procedures*, 27 AUSTL. TAX F. 525 (2012); Amy S. Wei, *Can Mediation Be the Answer to Taxpayers’ Woes?: An Examination of the Internal Revenue Service’s Mediation Program*, 15 OHIO ST. J. ON DISP. RESOL. 549, 549 (2000).

25 Tonya M. Scherer, *Alternative Dispute Resolution in the Federal Tax Arena: The Internal Revenue Service Opens Its Doors to Mediation*, 2 J. OF DISP. RESOL. 215 (1997).

26 Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 FLA. TAX REV. 599 (2007); John Hasseldine and Peggy Hite, *Key Determinants of Compliance and Non-Compliance*, 2007 TNT 205-40, 379 (2007).

27 Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia’s Tax Disputes Resolution Procedures*, 27 AUSTL. TAX F. 525, 528 (2012).

28 *Id.*

29 *Id.* at 525, 531.

30 *Id.* at 525, 531.

### The IRS Is Failing to Utilize the Potential Advantages ADR Offers

The IRS acknowledges the various benefits conferred by ADR. Despite operating a range of ADR programs, the IRS underutilizes this tool for achieving cost-effective, mutually desirable negotiated settlements.

The IRS offers the following ADR options:<sup>31</sup>

- Fast Track Settlement (FTS) — available to taxpayers in Large Business and International (LB&I), Small Business/Self Employed (SB/SE), and Tax Exempt and Government Entities (TE/GE) when issues are fully developed by Compliance; applicable to factual and legal disputes and eligible for Hazards of Litigation settlement; standard appeal rights still available if no agreement reached.<sup>32</sup>
- Fast Track Mediation – Collection (FTM) — available for Offer-in-Compromise or Trust Fund Recovery Penalty cases involving fully developed factual or legal issues; otherwise-applicable appeal rights retained if no agreement reached.<sup>33</sup>
- Post Appeals Mediation (PAM) — available for Non-Collection and Collection cases with respect to factual or legal disputes where no settlement has been achieved with Appeals; ability to litigate retained if no agreement reached.<sup>34</sup>

These ADR programs, however, accounted for only 306 case receipts during FY 2016—less than one half of one percent of the total Appeals case receipts for that same year.<sup>35</sup> Moreover, only 251 cases were actually resolved through a negotiated settlement during FY 2016. This ADR activity is shown in the following figure:

31 Fast Track Settlement cases are separately tracked based on the Operating Division from which they originate: Large Business and International (LB&I), Small Business/Self-Employed (SB/SE), and Tax Exempt and Government Entities (TE/GE). However, this discussion aggregates Fast Track Settlement cases for the sake of simplicity. Post-Appeals Mediation (PAM) for Non-Collection and Collection cases likewise are discussed in the aggregate for the same reason. Further, Appeals sometimes characterizes Appeals proceedings overall, as well as related programs such as Collection Due Process (CDP) appeals, the Collection Appeals Program (CAP), and Early Referral to Appeals as all constituting aspects of ADR. While all of these programs involve some degree of review and dialogue, they do not present meaningful alternatives to the IRS's current tax controversy process and therefore are not characterized as ADR for purposes of this discussion.

32 Rev. Proc. 2003-40, 2003-25 I.R.B. 1044; IRM 8.26.1 (Sep. 24, 2013); IRM 8.26.2 (Oct. 1, 2012); IRM 8.26.7 (Mar. 28, 2014).

33 Rev. Proc. 2016-57; IRM 8.26.3 (Dec. 5, 2014); *Id.*

34 Rev. Proc. 2014-63, 2014-53 I.R.B. 1014; IRM 8.26.5 (Aug. 17, 2015); IRM 8.26.9 (Mar. 16, 2015).

35 FY 2016 data provided by Appeals (Oct. 19, 2016).



**FIGURE 1.15.1**<sup>36</sup>

| ADR Program                             | Receipts   | Settlements | Settlement Percentage | Average Days to Settlement |
|---|------------|-------------|-----------------------|----------------------------|
| Fast Track Settlement – LB&I            | 65         | 70          | 108%                  | 72                         |
| Fast Track Settlement – SB/SE           | 142        | 105         | 74%                   | 51                         |
| Fast Track Settlement – TE/GE           | 17         | 11          | 65%                   | 55                         |
| Fast Track Mediation                    | 0          | 0           | n/a                   | n/a                        |
| Post Appeals Mediation – Non-Collection | 68         | 9           | 13%                   | 59                         |
| Post Appeals Mediation – Collection     | 14         | 2           | 14%                   | 124                        |
| <b>Total</b>                            | <b>306</b> | <b>197</b>  | <b>64%</b>            | <b>60</b>                  |

The settlement percentages in those relatively few cases pursued by taxpayers and accepted by the IRS appear to be positive, at least in the case of the FTS program. Nevertheless, the overall aggregate case receipts of the IRS's ADR program have been steadily declining over the last three years.<sup>37</sup> This drop can be seen in the following figure:

**FIGURE 1.15.2**<sup>38</sup>

| Fiscal Year | Receipts | Settlements | Settlement Percentage |
|-------------|----------|-------------|-----------------------|
| 2014        | 413      | 310         | 75%                   |
| 2015        | 383      | 232         | 61%                   |
| 2016        | 306      | 197         | 64%                   |

Many reasons contribute to the underutilization of ADR within the IRS. Initially, ADR is excluded in a wide range of circumstances, including cases that the IRS interprets as being subject to controlling precedent and most Campus Collection cases.<sup>39</sup> Moreover, it is only available where the IRS agrees to pursue it, effectively giving the IRS a strategic veto over all potential ADR proceedings.<sup>40</sup> If the IRS offered ADR on a broader scale with fewer limitations, ADR likely would be used more often and would become an option with which taxpayers and their representatives are increasingly well-versed.

Another inherent problem with ADR, as currently administered by the IRS, is that potential participants are not yet convinced that they will recognize enough meaningful time or cost savings to induce them

36 FY 2016 data provided by Appeals (Oct. 19, 2016). "Settlement percentage" is calculated by dividing the number of settlements by the number of receipts. This comparison is illustrative rather than exact, as occasionally, cases received in one year are settled in a subsequent year, which, among other things, can result in a settlement percentage in excess of 100 percent. The term "days to settlement" refers to the actual average number of days elapsed between the time a case is accepted into the ADR program and the time the parties reach an agreed settlement. Cases that are not successfully settled are excluded from this average. Appeals prefers the term "agreed closures" to the term "settlements" that has been adopted for purposes of this comparison.

37 Appeals response to TAS information request (Jun. 6, 2016), as supplemented by FY 2016 data provided by Appeals (Oct. 19, 2016).

38 *Id.*

39 Rev. Proc. 2003-40, § 3.03, 2003-25 I.R.B. 1045; Rev. Proc. 2016-57, § 3.04.

40 See, e.g., Rev. Proc. 2014-63, § 7.01, 2014-53 I.R.B. 1016.

to move beyond the standard tax controversy procedures with which they are most comfortable.<sup>41</sup> As discussed above, the experiences of other governmental agencies and certain foreign tax authorities indicate that ADR flourishes once parties become convinced that an equitable outcome can be obtained more quickly and cheaply than through standard administrative and judicial channels. The IRS has yet to design an ADR system possessing sufficient volume and efficiency to persuasively make such a case.

Additionally, acceptance of ADR within the IRS may well be inhibited by the perception, deserved or not, that the “neutral facilitator” lacks independence. In commercial ADR, external neutrals, completely unassociated with the interested parties, act as facilitator. In the case of many successful government ADR programs, such as that developed by SSA, the neutral may technically be part of the agency, but the neutral is housed in a separate group within the agency and generally has no duties other than working in the ADR program.<sup>42</sup> By contrast, the IRS uses Appeals Officers as neutrals who are drawn from the Office of Appeals and who are not solely dedicated to ADR cases. When not involved in an ADR proceeding, these neutrals generally work the standard Appeals docket. As a result, taxpayers contemplating ADR may question whether they are receiving a truly independent neutral and whether the outcomes produced by ADR would be any more advantageous than what would be generated via a standard Appeals proceeding.

### The IRS Can Transform Its ADR Program into a Valuable Component of Tax Administration

In order to reverse the relative unpopularity of its ADR program, the IRS must institute some systemic improvements. As a threshold matter, the scope of ADR availability should be substantially increased and the effective IRS veto power removed. ADR should generally be available to all taxpayers upon request.<sup>43</sup> If the IRS wishes the program to succeed, it must allow taxpayers to choose when ADR would be beneficial.

As part of this expansion, the IRS should employ ADR actively at the Compliance level as well as at the Appeals stage. As has been suggested by the Canadian Tax Mediation Association, ADR during the examination process can help the parties better understand the issues and reach agreement on disputed facts.<sup>44</sup> This clarification of positions early on can often resolve cases much sooner in the proceedings than would otherwise occur and can help minimize the tendency of the parties to become entrenched in their arguments.<sup>45</sup> Moreover, even if resolution is not achieved, a facilitated dialogue can narrow and develop the issues so that time and resources can be more effectively focused later in the administrative process.

In order for taxpayers to embrace a voluntary program, they must be persuaded that it will produce beneficial, cost-effective outcomes. As a result, the IRS must expand the program, publicize its availability, and encourage its use through effective communications to taxpayers automatically generated

41 Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 59 (2012) (on file in TAS archives).

42 SSA, *Hearing and Appeals*, [https://www.ssa.gov/appeals/hearing\\_process.html](https://www.ssa.gov/appeals/hearing_process.html) (last visited Mar. 16, 2016).

43 Reasonable exceptions to this general availability would include frivolous requests intended to delay or impede tax administration.

44 Canadian Tax Mediation Association, *Tax Mediation: An Innovation Promoting Transparent Exchanges Between Tax Authorities and Taxpayers* (2015) (on file in TAS archives).

45 See, e.g., Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 74 (2012) (on file in TAS archives).

by procedural triggers.<sup>46</sup> As part of this effort, the IRS should publish evaluative statistics, such as the percentage of settled ADR cases and the average hours spent to resolve an ADR case versus average hours to resolve standard cases. If this data is positive, that information will go a long way toward building the popularity of ADR programs. On the other hand, if the information is less-than-compelling, the IRS must figure out why and take decisive steps to make meaningful changes in its ADR program. Until quantifiable statistics indicating an effective and desirable program are presented, taxpayers' interest in ADR likely will remain tepid.

The average hours to resolution measure is particularly significant in that the time spent to resolve a case directly correlates to costs incurred by both taxpayers and the IRS. Effective ADR programs generally can demonstrate that the hours required to resolve an ADR case are substantially fewer than those spent to resolve standard administrative or judicial proceedings.<sup>47</sup> While expanding its ADR program, the IRS should, at the same time, reexamine applicable procedures in light of this principle and take all possible steps to streamline the efficiency and timeliness of case resolution. Among other things, this streamlining can be achieved by improving the scheduling process, reducing related paperwork, increasing accessibility to ADR personnel, and allowing video conferencing where requested by the parties.<sup>48</sup> As part of this fundamental redesign of its ADR program, the IRS should also consider circumstances in which a revised and improved arbitration offering could supplement mediation as an attractive and efficient alternative to litigation.

Likewise, to perpetuate the independence (both actual and perceived) of neutral facilitators, the IRS should establish a separate unit housing neutrals assigned solely to the IRS's ADR program. This reorganization would increase the trust of taxpayers that a neutral was indeed neutral and would further taxpayers' *right to a fair and just tax system*. Additionally, it would allow IRS personnel assigned to this unit to focus on refining their skills and enhancing their performance as ADR facilitators and, where applicable, decision-makers.

46 Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 62 (2012) (on file in TAS archives).

47 See, e.g., Conflict Prevention and Resol. Ctr., U.S. Envtl. Protection Agency, *FY 2014 Environmental Collaboration and Conflict Resolution (ECCR) Policy Report to OMB-CEQ*, 18-19 (Feb. 17, 2015). One of the reasons the IRS excludes most Campus Collection cases from ADR may be because these cases are already designed for quick resolution by virtue of minimal direct contact with taxpayers and limited issue development. Nevertheless, higher levels of taxpayer satisfaction and increased long-term tax compliance could be achieved by making Campus cases eligible for ADR. Further, the refusal to do so raises an access to justice issue for lower-income taxpayers, who have a large portion of their cases routed to Campuses. While lower-income taxpayers without representation may be less likely to initiate ADR proceedings than other taxpayers, they can obtain assistance from Low Income Tax Clinics (LITCs), which operate in a similar fashion to Legal Aid Societies in SSA ADR hearings. First, however, they must be informed by Appeals that LITCs exist and that LITCs can assist them in the ADR process.

48 Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 20 (2012) (on file in TAS archives).

## CONCLUSION

ADR has been widely embraced by businesses, various federal agencies, and tax authorities of certain foreign countries. Moreover, studies in this area demonstrate that efficient ADR can have a positive impact on tax compliance and tax administration. The IRS has acknowledged the benefits of ADR but has yet to capitalize on ADR's vast potential for increasing the quality of tax administration. Throughout FY 2016, the combined IRS ADR program generated less than 306 case receipts.

The IRS can realize the advantages of a quality ADR program by implementing a series of systemic changes, such as expanding the scope of its ADR program, publishing applicable ADR data, and establishing a separate ADR unit. Improving and expanding ADR would require a short-term investment but would yield long-term cost savings for both the IRS and taxpayers. It also would improve taxpayer satisfaction and thereby contribute to voluntary tax compliance.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Expand ADR to all taxpayers upon request, including at the Compliance level, as well as at the Appeals stage.
2. Publish quarterly data relating to the settlement percentages and the cost-effectiveness of ADR.
3. Reduce the administrative burdens surrounding ADR, allow video conferencing where desired by the parties, and examine scenarios in which a redesigned arbitration option can represent an attractive alternative to litigation.
4. Establish a separate unit to house IRS personnel assigned exclusively to the ADR program.

MSP  
#16**FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights****RESPONSIBLE OFFICIALS**

Douglas W. O'Donnell, Commissioner, Large Business and International Division  
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

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- *The Right to Quality Service*
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- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

The Foreign Account Tax Compliance Act (FATCA) was passed in 2010 in response to IRS and congressional concerns that U.S. taxpayers were not fully disclosing the extent of financial assets held abroad.<sup>2</sup> In passing FATCA, Congress hoped to reign in “tax cheats” and to collect substantial amounts of previously inaccessible revenue.<sup>3</sup> Although the concerns giving rise to FATCA are understandable, the IRS’s approach to FATCA implementation has created significant compliance burdens and risk exposures to a variety of impacted parties including non-resident aliens, U.S. citizens living abroad, and foreign financial institutions (FFIs).<sup>4</sup>

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat 71 (2010) (adding Chapter 4 of IRC §§ 1471-1474; 6038D), collectively referred to as the Foreign Account Tax Compliance Act (FATCA).
- 3 See e.g., J. Comm. on Tax’n (JCT), “*Estimated Revenue Effects of the Revenue Provisions Contained In Senate Amendment 3310, the ‘Hiring Incentives to Restore Employment Act,’ Under Consideration by the Senate*,” JCX-5-10 (Feb. 23, 2010), Doc 2010-3977, 2010 TNT 36-20; Brian Kindle, *FATCA may identify tax cheats, but its dragnet for financial criminals may produce an even bigger yield*, Association of Certified Financial Crime Specialists (Mar. 1, 2012), <http://www.acfcs.org/fatca-may-identify-tax-cheats-but-its-drag-net-for-financial-criminals-may-produce-an-even-bigger-yield/>.
- 4 See e.g., SIFMA, *Comments on the Final FATCA Regulations* (June 21, 2013), 2, <http://www.sifma.org/comment-letters/2013/sifma-submits-comments-to-the-us-department-of-treasury-and-the-irs-on-final-fatca-regulations/>; Treas. Reg. § 1.1474-1(f); Letter from American Citizens Abroad to Jacob Lew, Sec’y, Treasury, and John Koskinen, Cmm’r, IRS (Sept. 15, 2015), <https://www.americansabroad.org/media/files/files/f74d1b79/same-country-exemption-letter.pdf>. The hardships experienced by non-resident aliens often occur under Chapter 3 of the IRC (IRC §§ 1441-1443), which is not part of FATCA. Nevertheless, as it went about implementing FATCA, the IRS determined that it would begin treating Chapter 3 refund claims synonymously with its treatment of Chapter 4 refunds. See Notice 2015-10, 2015-20 I.R.B. 965. As a result, the issues experienced by non-resident aliens when filing Forms 1040NR, U.S. Nonresident Alien Income Tax Return, seeking amounts shown as withheld on Forms 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding, are discussed in this Most Serious Problem as being related to FATCA.

The IRS has adopted an enforcement-oriented regime with respect to international taxpayers.<sup>5</sup> Its operative assumption appears to be that all such taxpayers should be suspected of fraudulent activity, unless proven otherwise. This assumption results in the IRS ignoring stakeholders, dismissing useful comments and suggestions, and misallocating resources.<sup>6</sup> At various points, this perspective has resulted in the IRS freezing over 102,000 refund claims from non-resident aliens, creating and then suspending use of a semi-automated matching tool, and implementing a regime that places unnecessary burdens on both taxpayers and businesses.<sup>7</sup>

The IRS has taken this approach despite a lack of comprehensive statistical data establishing the existence of widespread noncompliance or fraud on the part of Form 1040NR filers seeking Form 1042-S refunds, and despite TAS analysis indicating that the vast majority of these taxpayers actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population.<sup>8</sup> Instead, the IRS should pursue a service- and assistance-oriented strategy for the vast majority of international taxpayers, coupled with a data-driven, narrowly targeted enforcement program. This approach would no longer disadvantage the compliant majority in an effort to prevent potential fraud by a few bad actors. In the meantime, the National Taxpayer Advocate remains concerned that:

- IRS processes for reviewing and validating Chapter 3 and Chapter 4 refund requests continue to unnecessarily burden taxpayers;
- Contemplated Chapter 3 and Chapter 4 regulations would explicitly make the availability of credits and refunds to covered taxpayers contingent on the actions of withholding agents;
- U.S. expatriates are particularly vulnerable to FATCA-related hardships;
- Passport revocations and denials could cause substantial problems for both U.S. expatriates and residents; and
- FFIs face regulatory uncertainty, reputational risk, and ongoing expenditures regarding FATCA and related information reporting obligations.

5 National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84.

6 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84; National Taxpayer Advocate 2015 Annual Report to Congress 346-52; National Taxpayer Advocate 2013 Annual Report to Congress 238-48.

7 Compliance Data Warehouse (CDW), Individual Master File (IMF) and Individual Returns Transaction File (IRTF) Extract Cycle as of 201634 (Aug. 2016); IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

8 TAS bases this determination on an analysis of data relating to reporting compliance. For example, since 2008 the “no change” rate for cases involving audits of Form 1040NR filers who also filed a Form 1042-S has generally exceeded the audit “no change” rate for all Form 1040NR filers as well for as all Form 1040 filers. Data drawn July 12, 2016 from IRS CDW, IRTF, IRMF, and Audit Information Management System (AIMS). Further, Form 1040NR taxpayers claiming Form 1042-S refunds have a lower percentage of high-scoring Discriminant Index Function (DIF) returns in comparison to filers overall — see particularly Total Positive Income (TPI) Class 72, which encompassed most taxpayers in this group. Data drawn March 25, 2016 for tax year (TY) 2014 from IRS CDW, IRTF and IMF.



## ANALYSIS OF PROBLEM

### IRS Processes for Reviewing and Validating Chapter 3 and Chapter 4 Refund Requests Continue to Unnecessarily Burden Taxpayers

The FATCA Program has generated a number of technology-based data management systems. These systems, on which over \$100 million have been spent, are designed to:<sup>9</sup>

- Allow FFIs to establish online accounts with the IRS and participate in a standardized worldwide residence-based information reporting regime;
- Facilitate financial institution reporting to the IRS and the exchange of information between the IRS and foreign tax authorities under intergovernmental agreements; and
- Compile FATCA-related data filed by taxpayers, such as via Form 8938, *Statement of Specified Foreign Financial Assets*, and Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, and match those against related compliance data coming from FFIs and withholding agents.

Many of these systems, however, are not fully functional and are not yet adequate to process the various data streams being collected from other governments, FFIs, and withholding agents under FATCA. Large amounts of data are being collected, but the ability to effectively match that data as part of the tax compliance process has not been fully developed. For example, although the IRS spent \$15 million developing and implementing an automated matching tool with respect to Chapter 3 and Chapter 4 withholding and refunds, that tool has not produced the intended business results, and the IRS does not have a timetable for when it will be remedied and brought online.<sup>10</sup>

In the interim, the IRS pursued its systemic matching program through the use of a newly developed semi-automated matching tool supplemented by high-level manual review.<sup>11</sup> This program generated widespread disallowances of Form 1042-S refunds claimed by non-residents on their Forms 1040NR.<sup>12</sup> This policy fell especially hard on international students, who, as a category, generally seek small-dollar refunds and represent a particularly low-risk taxpayer group.<sup>13</sup> Many of these disallowances occurred for reasons that often were beyond taxpayers' control, such as transcription errors within the IRS and poor data quality.<sup>14</sup>

The National Taxpayer Advocate and various stakeholders raised concerns about the matching program and the problems it caused for non-residents.<sup>15</sup> These cautions, however, were repeatedly dismissed by

9 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-20-077, 2-3 (Aug. 31, 2016). See the TIGTA report for a more detailed discussion of the FATCA Program systems deployment and the actual or contemplated functionalities associated with each release.

10 TIGTA, Ref. No. 2016-20-077, 4, 8 (Aug. 31, 2016).

11 Internal Revenue Manual (IRM) 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (Aug. 1, 2016). (See Servicewide Electronic Research Program: <http://serp.enterprise.irs.gov/databases/irm.dr/current/21.dr/21.8.dr/21.8.1.dr/21.8.1.11.14.2.htm>).

12 IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

13 *Id.*; National Taxpayer Advocate 2017 Objectives Report to Congress 123-30.

14 Notes from TAS conference call with Large Business and International (LB&I) (Apr. 29, 2016) (on file in TAS archives).

15 TAS General Project 34152; Briefing paper, NACUBO, *Widespread Tax Problems for International Students* (Apr. 21, 2016) (on file in TAS archives); Letter from Donna Kepley, President, Arctic International LLC, to Nina Olson, National Taxpayer Advocate (Apr. 18, 2016) (on file in TAS archives).

the IRS officials charged with operating the program.<sup>16</sup> Only when congressional inquiries were received did the IRS take the problems seriously.<sup>17</sup> Ultimately, an investigation of the process determined that IRS transcription errors and rigid processes were primarily responsible for the excessive number of false positives generated by the systemic matching program.<sup>18</sup>

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... the IRS should pursue a service- and assistance-oriented strategy for the vast majority of international taxpayers, coupled with a data-driven, narrowly targeted enforcement program.

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The IRS announced that it would lift the freezes placed on refunds of withholding tax reported on Forms 1042-S and that it would discontinue its policy of instituting future freezes until it redesigned the process for examining such claims.<sup>19</sup> This redesign, which is currently ongoing, appears to be primarily focused on ways of alleviating the most obvious and egregious inequities to which taxpayers were subject under the prior program. Rather than retaining the prior concepts, which derive from the incorrect assumption that international transactions are more likely to be fraudulent, the process redesign should center around improving and then adapting the already-developed policies, procedures, and systems applied in the domestic context to the majority of international taxpayers.<sup>20</sup> Such an approach would effectively utilize IRS resources and fairly apply the U.S. tax laws to international taxpayers. In order for this effort to be successful, however, the IRS must abandon its enforcement-only bias against international taxpayers, become less insular in its approach, better coordinate among its own Operating Divisions, and listen to the observations and recommendations of the National Taxpayer Advocate and stakeholders who have valuable perspectives to contribute.

The IRS should treat domestic and international taxpayers similarly unless and until comprehensive statistical data indicates significantly different compliance patterns for specific groups of taxpayers. To the extent those patterns are established, the IRS would have a basis for treating certain categories of taxpayers differently and would also have a means of implementing effective and proportionate compliance initiatives (including enforcement) against those groups most likely to be noncompliant. Until such time,

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16 TAS General Project 34152.

17 Letter from Rep. Lloyd Doggett to John Koskinen, Comm'r, IRS (Apr. 22, 2016) (on file in TAS archives); Letter from John Koskinen, Comm'r, IRS to Rep. Lloyd Doggett (June 6, 2016) (on file in TAS archives).

18 IRM 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (Aug. 1, 2016). (See SERP: <http://serp.enterprise.irs.gov/databases/irm.dr/current/21.dr/21.8.dr/21.8.1.dr/21.8.1.11.14.2.htm>); IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding*, (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

19 IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

20 In the Return Integrity & Compliance Services (RICS) Integrity & Verification Operation (IVO) employed domestically, the IRS freezes potentially questionable claims while seeking to validate the withholding through its own systems and directly with the employer. IRM 25.25.1.1 (Feb. 19, 2015). See also National Taxpayer Advocate 2015 Annual Report to Congress 47 Fig. 1.4.1. This program itself is in need of substantial improvements in order to achieve an acceptable target rate of false positives.

the IRS's enforcement-oriented approach with respect to international taxpayers likely will continue to be unsystematic, unjustified, and unsuccessful.<sup>21</sup>

### Contemplated Chapter 3 and Chapter 4 Regulations Would Explicitly Make the Availability of Credits and Refunds to Covered Taxpayers Contingent on the Actions of Withholding Agents

As previously discussed by the National Taxpayer Advocate, this new international enforcement regime under which the burdens and risks are disproportionately shifted to largely compliant taxpayers takes troubling shape in Chapter 3 and Chapter 4 withholding regulations currently under development by the IRS and Treasury.<sup>22</sup> Specifically, these regulations would allow full credits or refunds only after a taxpayer files a tax return accompanied by the requisite Form 1042-S if the IRS can confirm that the withholding agent remitted the full amount of the aggregate liabilities for which the withholding agent is responsible.<sup>23</sup> In the event that a withholding agent has only partially satisfied its deposit requirements with the IRS, the regulations would provide for a *pro rata* allocation of the amount deposited among taxpayers seeking to claim credits or refunds for the withholding in question.<sup>24</sup>

Some exceptions may be developed for certain scenarios, such as in cases where the under deposit of tax is *de minimis*, or in cases where the withholding agent in question has a demonstrated history of compliance with its deposit requirements.<sup>25</sup> These proposed exceptions, however, would not always address circumstances where proper amounts were *actually withheld* from taxpayers' accounts. Thus, good-faith taxpayers, for reasons completely beyond their control, could be denied a credit or refund of amounts withheld pursuant to U.S. tax law. This shift in creditor risk from the IRS, which is best positioned to enforce and collect withholding liabilities, to individual taxpayers, who are often powerless to remedy such failures, jeopardizes taxpayers' *right to a fair and just tax system* and *right to pay no more than the correct amount of tax*.<sup>26</sup> Such a regime undermines the fundamental perceptions of equity on which the voluntary tax compliance system depends.<sup>27</sup>

As in the domestic context, the IRS should accept responsibility for bringing its enforcement resources to bear against noncompliant withholding agents, rather than innocent taxpayers.<sup>28</sup> This approach is feasible as withholding agents, even those active in the international arena, are overwhelmingly domestic (approximately 86 percent) and, to the extent they engage in noncompliant behavior, can be compelled by the IRS to remit the withholding payments they have collected, even where non-resident taxpayers are involved.<sup>29</sup>

21 IRC § 6611(e)(4) provides that no overpayment interest will accrue on Chapter 3 and Chapter 4 refunds paid within 180 days of when the tax return is due or filed, whichever is later. Nevertheless, this statutory authority to avoid paying interest on such refunds should not be construed as a mandate for perpetually delaying those refunds in the absence of a reasonable basis for doing so and without an effective system for reviewing the claims. Simply because the IRS *can* freeze Chapter 3 and Chapter 4 refunds without quickly incurring interest charges, does not mean that the IRS *should* freeze these refunds at all or for the full 180 days.

22 National Taxpayer Advocate 2015 Annual Report to Congress, 346-52. See also Notice 2015-10, 2015-20 I.R.B. 965.

23 Notice 2015-10, III.A., 2015-20, I.R.B. 965.

24 *Id.*

25 *Id.*

26 See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

27 Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 Fla. Tax Rev. 599 (2007); John Hasseldine and Peggy Hite, *Key Determinants of Compliance and Non-Compliance*, 2007 TNT 205-40, 379 (2007).

28 National Taxpayer Advocate 2015 Annual Report to Congress, 346-52.

29 LB&I response to TAS information request (Sep. 6, 2016). Treas. Reg. § 1.1461-1T(c). See also IRC §§ 6601, 6651(a)(2), and 6656.

### U.S. Expatriates Are Particularly Vulnerable to Foreign Account Tax Compliance Act (FATCA)-Related Hardships

The IRS's enforcement-based orientation regarding offshore issues can also be especially problematic for U.S. expatriates. Some American citizens residing abroad have reported experiencing banking “lock-out” by FFIs that have chosen to eliminate their U.S. client base in order to minimize their exposure to FATCA reporting requirements and potential penalties.<sup>30</sup> As a recommendation to help solve this problem and minimize the burden of FATCA compliance for both individual U.S. taxpayers and FFIs, the National Taxpayer Advocate previously proposed that the IRS and Treasury adopt a “same country exception.”<sup>31</sup> This exception would exclude from FATCA coverage financial accounts held in the country in which a U.S. taxpayer is a *bona fide* resident, would mitigate concerns about the collateral consequences of FATCA raised by U.S. non-residents, and would reduce reporting burdens faced by FFIs.

No action has been taken by the IRS or Treasury with respect to this recommendation. This idea of a same country safe harbor has also been placed before Congress by the National Taxpayer Advocate, American Citizens Abroad, and Democrats Abroad.<sup>32</sup> The National Taxpayer Advocate reiterates her recommendation that the FATCA regime incorporate a same country exception.

In a recent survey of U.S. expatriates conducted by Americans Abroad Global Foundation and the University of Nevada-Reno, 91 percent of respondents indicated that FATCA compliance placed them at a disadvantage compared with ordinary citizens from their country of residence.<sup>33</sup> Further, 86 percent articulated the belief that the law should be revised to reduce some of the associated burdens by adopting a “Same Country Exception.”<sup>34</sup> The survey report concludes, “There appears to be a consensus among many respondents that their government does not recognize how the FATCA legislation is negatively affecting them and limiting their ability to maintain banking and financial relationships. Most feel that their government is not doing enough to try and address their concerns and problems.”<sup>35</sup>

Perhaps because of the perceptions expressed in the University of Nevada study, along with other reasons including banking lock-out and the additional compliance burdens imposed by FATCA and related information reporting regimes, the number of expatriates renouncing their U.S. citizenship has continued to rise.<sup>36</sup> In calendar year 2015, a record 4,279 individuals renounced their U.S. citizenship or long-term residency — a 25 percent increase over 2014, which likewise had been a record-breaking year.<sup>37</sup> As

30 See Letter from American Citizens Abroad to Jacob Lew, Sec'y, Treasury, and John Koskinen, Cmm'r, IRS (Sept. 15, 2015), <https://www.americansabroad.org/media/files/files/f74d1b79/same-country-exemption-letter.pdf> (last visited Oct. 21, 2016).

31 *National Taxpayer Advocate Seeks End to Duplicative FATCA Reporting*, 2015 TNT 71-16 (Apr. 14, 2015).

32 Letter from American Citizens Abroad to Jacob Lew, Sec'y, Treasury, and John Koskinen, Cmm'r, IRS (Sept. 15, 2015), <https://www.americansabroad.org/media/files/files/f74d1b79/same-country-exemption-letter.pdf>; Democrats Abroad, *FATCA Update: October - December 2015*, [http://www.democratsabroad.org/fatca\\_update\\_oct\\_december\\_2015](http://www.democratsabroad.org/fatca_update_oct_december_2015) (last visited Feb. 12, 2016). See also National Taxpayer Advocate 2015 Annual Report to Congress 353-62.

33 *A Study of the Consequences of the Foreign Account Tax Compliance Act on Americans Living Overseas: Survey Results and Interpretations*, University of Nevada, 10, Table 1. <http://www.unr.edu/Documents/business/accounting/FATCASurveyReportFinalDraftDecember2015.pdf>.

34 *Id.* at 13.

35 *Id.* at 14.

36 81 Fed. Reg. 6598-02, 2016-02312.

37 International Tax Blog, *New Expatriate Record for 2015 – Nearly 4,300 Expatriations* (Feb. 5, 2016) [http://intltax.typepad.com/intltax\\_blog/2016/02/new-expatriate-record-2015-nearly-4300-expatriations.html](http://intltax.typepad.com/intltax_blog/2016/02/new-expatriate-record-2015-nearly-4300-expatriations.html); Russell Newlove, *Why Expat Americans are Giving up their Passports*, BBC News (Feb. 12, 2016), <http://www.bbc.com/news/35383435>. See also 81 Fed. Reg. 6598-02, 2016-02312.

explained by one expatriate, “If it weren’t for FATCA and the decision by the bank [lock-out], I’d never be doing this.”<sup>38</sup>

### Passport Revocations and Denials Could Cause Substantial Problems for Both U.S. Expatriates and Residents

Another enforcement provision that exacerbates the disproportionate burden on expatriates is the recently enacted law allowing for the revocation or denial of passports for taxpayers who owe the IRS more than \$50,000.<sup>39</sup> For U.S. residents, the lack of a passport typically would constitute an irritation; for expatriates, however, it could represent a crisis: “Americans abroad need their passports for many routine activities of daily life, such as banking, registering in a hotel, or registering a child for school, and mistakes could be disastrous.”<sup>40</sup> Additionally, concern has been expressed regarding potentially dangerous in-country events or circumstances to which expatriates might sometimes be exposed because of passport revocation.<sup>41</sup>

The IRS is currently developing processes and procedures relating to the implementation of this additional tax enforcement mechanism. In this process, the IRS should learn from its experiences with Chapter 3 and Chapter 4 refunds and carefully coordinate and collaborate within its own Operating Divisions and within the Department of State. Moreover, the IRS should protect the rights of taxpayers by, among other things:

- Broadly interpreting hardship and other discretionary exclusions;
- Providing an administrative appeal before certifying a “seriously delinquent tax debt” to the Department of State;
- Encouraging the Department of State to adopt expansive definitions of humanitarian and emergency exceptions; and
- Informing the taxpayer of the availability of TAS assistance before passport revocation or denial occurs.<sup>42</sup>

Great care should be taken in the implementation of this law to ensure that its application is reasonable and proportionate with respect to both U.S. citizens residing abroad and in the United States.

### Foreign Financial Institutions (FFIs) Face Regulatory Uncertainty, Reputational Risk, and Ongoing Expenditures Regarding the Foreign Account Tax Compliance Act (FATCA) and Related Information Reporting Obligations

The IRS’s shift to enforcement-based international tax administration places significant compliance burdens and costs of implementation on FFIs as well as taxpayers. For example, a broad range of U.S.-source payments to FFIs are subject to a 30 percent withholding tax, unless the FFIs agree to provide

38 Russell Newlove, *Why Expat Americans are Giving up their Passports*, BCC News (Feb. 12, 2016), <http://www.bbc.com/news/35383435>.

39 Fixing America’s Surface Transportation Act (FAST), Pub. L. No. 114-94, Title XXXII, Subtitle A, § 32101 (Dec. 4, 2015), adding IRC § 7345. See also Chris Matthews, *Pay Your Taxes or Lose Your Passport*, FORTUNE MAGAZINE (Nov. 20, 2015), <http://fortune.com/2015/11/20/irs-taxes-passport/>.

40 Chris Matthews, *Pay Your Taxes or Lose Your Passport*, FORTUNE MAGAZINE (Nov. 20, 2015), <http://fortune.com/2015/11/20/irs-taxes-passport/>.

41 Alexander Lewis, *New Law Will Revoke Passports for Delinquent Tax Debts*, 2015 TNT 234-6 (Dec. 7, 2015). See also Fixing America’s Surface Transportation Act (FAST), Pub. L. No. 114-94, Title XXXII, Subtitle A, § 32101 (Dec. 4, 2015).

42 See Fixing America’s Surface Transportation Act (FAST), Pub. L. No. 114-94, Title XXXII, Subtitle A, § 32101 (Dec. 4, 2015), adding IRC § 7345.

comprehensive information regarding accounts of U.S. taxpayers.<sup>43</sup> Additionally, FATCA charges withholding agents with the responsibility of determining whether they are obliged to undertake FATCA withholding and implementing it when required.<sup>44</sup>

In turn, FFIs who have reached agreements with the IRS to avoid being subject to systematic withholding must impose withholding on any of their own customers defined as “recalcitrant account holders.”<sup>45</sup> Although FFIs have some latitude in identifying recalcitrant account holders, customers are in jeopardy of facing withholding if they are unable to provide the FFI with either a Form W-9 to certify they are U.S. persons, or a Form W-8BEN to certify they are foreign persons.<sup>46</sup> When in doubt, FFIs are incentivized to over-withhold, as failure to do so can result in liability for the uncollected withholding and exposure to penalties.<sup>47</sup>

FATCA implementation has been characterized by a change from information gathering to withholding and enforcement.<sup>48</sup> This heavy-handed approach, especially when combined with the complexity surrounding IRS requirements, has negative consequences, both for FFIs and the IRS. For example, the IRS has made a number of changes to Form 8966, *Foreign Account Tax Compliance Act (FATCA) Report*, which is used to collect information for identifying noncompliance, without providing helpful instructions or adequately coordinating with foreign tax authorities.<sup>49</sup> As explained by industry stakeholders in a 2015 IRS FATCA roundtable:

Complexity is a big issue under FATCA. Regional/community banks that do not have the resources to make all of the changes needed to respond to the complexity are struggling with clarity and lack of understanding of what the rules are. As a result, FFIs run the risk of IRS sanctions if they mistakenly use incorrect codes for reporting or misinterpret the rules in validating W-8s.<sup>50</sup>

43 IRC § 1471(a); IRC § 1473(1). IRC § 1471(d)(1)(B) excepts from the reporting and withholding requirements those accounts that are held by individuals at the same FFI and have an aggregate value of \$50,000 or less. Note that an FFI can provide information either as a participating FFI or pursuant to an intergovernmental agreement negotiated between the U.S. and the FFI's home country.

44 IRC §§ 1471 – 1474; Notice 2016-08, 2016-06 I.R.B. 304.

45 IRC § 1471(b)(1)(D)(i).

46 IRS Form W-9, *Request for Taxpayer Identification Number and Certification* (Dec. 2014); IRS Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)* (Feb. 2014).

47 IRS, *IRS FATCA Roundtable: Industry Concerns and Suggestions*, 5 (Nov. 16, 2015). See also Notice 2016-08, 2016-06 I.R.B. 304.

48 *Id.* at 3.

49 *Id.*

50 *Id.* at 2-3.



The IRS could reduce compliance burdens on FFIs and ultimately achieve more effective results if it adopted a collaborative model of tax administration with respect to FFIs. A significant step in this regard would be to simplify and clarify the definition of “good faith efforts” under IRS published guidance.<sup>51</sup> As things stand now, “... over-reporting, over-withholding, and misinformation could make it difficult for the IRS to use the information it is receiving as intended, and may lead to false-positives.”<sup>52</sup> The IRS should “distinguish between FFIs that are colluding with their local authorities to avoid FATCA and FFIs that are making genuine, ‘good faith’ efforts to comply, but are unable to because of the complexity of the law.”<sup>53</sup>

The IRS should acknowledge the colossal efforts undertaken by FFIs to comply with FATCA rules. At the same time, it should begin working cooperatively with them to maintain and improve reporting rather than simply penalizing them for noncompliance. Instead of threatening penalties, the IRS should encourage correction of erroneous reporting and focus its efforts on giving FFIs the clarity and consistent guidance needed for reasonable, cost-effective compliance with FATCA.

## CONCLUSION

The IRS has gradually shifted to an enforcement-based regime with respect to international taxpayers.<sup>54</sup> The underlying assumption is that all such taxpayers should be suspected of fraudulent activity until they can prove otherwise, an outlook that causes the IRS to mistrust stakeholders, dismiss useful comments and suggestions, and misallocate resources.<sup>55</sup>

One manifestation of this perspective has been the development and implementation of processes for reviewing and validating Chapter 3 and Chapter 4 refund requests that continue to unnecessarily burden taxpayers. Contemplated Chapter 3 and Chapter 4 regulations would exacerbate these problems by making the availability of credits and refunds to covered taxpayers contingent on the actions of withholding agents, over whom taxpayers have little, if any, control. Further, U.S. expatriates are particularly vulnerable to FATCA-related hardships such as banking lock-out and other conceptually similar legislation, such as IRC § 7345, which allows for potential passport revocation and denial.

FFIs likewise face regulatory uncertainty, reputational risk, and ongoing expenditures regarding FATCA and related information reporting obligations. The IRS could achieve better results and reduce burdens placed on taxpayers and FFIs if it followed a collaborative model of taxation that sought to identify and focus on the relatively few bad actors while at the same time recognizing the good faith efforts of the compliant majority.

51 IRS, *IRS FATCA Roundtable: Industry Concerns and Suggestions*, 3 (Nov. 16, 2015).

52 *Id.* at 7.

53 *Id.* at 7.

54 National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84.

55 See *id.* National Taxpayer Advocate 2015 Annual Report to Congress 346-52; National Taxpayer Advocate 2013 Annual Report to Congress 238-48.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Implement policies and procedures for reviewing and issuing Chapter 3 and Chapter 4 refund claims that mirror those processes currently in place with respect to domestic taxpayers under IRC § 31 and related regulations.
2. Adopt a same country exception that excludes from FATCA coverage financial accounts held in the country in which a U.S. taxpayer is a *bona fide* resident.
3. Protect the rights of taxpayers potentially impacted by the new law regarding revocations and denials of passports by broadly interpreting hardship and other discretionary exclusions; providing an administrative appeal before certifying a “seriously delinquent tax debt” to the Department of State; working with the Department of State to encourage it to adopt expansive definitions of humanitarian and emergency exceptions; and informing taxpayers of the availability of TAS assistance before passport revocation or denial occurs.
4. Reduce burdens on FFIs by adopting a collaborative model of tax administration that encourages FFIs to correct erroneous reporting and focuses on providing the clarity and consistent guidance needed for reasonable, cost-effective compliance with FATCA.

MSP  
#17**INSTALLMENT AGREEMENTS (IAs): The IRS Is Failing to Properly Evaluate Taxpayers' Living Expenses and Is Placing Taxpayers in IAs They Cannot Afford****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

Internal Revenue Code (IRC) § 6159 authorizes the IRS to enter into an agreement with a taxpayer to pay any tax due in installments to facilitate full or partial collection of the tax.<sup>2</sup> Collectively, these agreements are known as installment agreements (IAs), of which the IRS offers several types to assist taxpayers in resolving their tax liabilities.<sup>3</sup> Across all types of IAs, the default rate — the rate at which taxpayers fail to make payments as agreed — is over 13 percent in fiscal year (FY) 2016.<sup>4</sup> This seemingly low overall default rate masks issues with certain types of IAs and economic hardship for taxpayers who continue to pay IAs despite not having enough income to support the payments proposed by the IRS. TAS review of IRS data found:

- Partial Pay Installment Agreements (PPIAs) have a default rate of nearly 28 percent;<sup>5</sup>
- IAs worked by IRS field employees and Automated Collection Services (ACS) defaulted at rates of 26 and 20 percent, respectively;<sup>6</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 IRC § 6159.

3 Internal Revenue Manual (IRM) 5.14, *Installment Agreements* (Jan. 7, 2016).

4 IRS, *Installment Agreement (IA) Default Rate Report* (Oct. 6, 2016). Overall, 13.23 percent of all IAs defaulted in FY 2016.

5 IRS, *IA Default Rate Report* (Oct. 6, 2016). PPIAs defaulted at a rate of 27.84 percent in FY 2016.

6 *Id.* Field worked IAs defaulted at a rate of 26.24 percent and Automated Collection Services (ACS) IAs defaulted at a rate of 20.11 percent in FY 2016.

- Nearly 300,000 taxpayers who should have qualified for currently not collectible (CNC) status had entered into installment agreements in calendar year 2014 despite their income being below the IRS allowable living expense (ALE) standards;<sup>7</sup> and
- Over 46,000 taxpayers with balances due of greater than \$10,000, whose incomes were less than their ALEs, and who entered into IAs in 2014 subsequently defaulted by FY 2016.<sup>8</sup> This is about 43 percent of the taxpayers with these characteristics.

The higher rates of default on certain types of IAs and the number of taxpayers who may be paying their IAs at the expense of necessary living expenses indicates that the IRS is not conducting appropriate financial analysis or providing the tools for taxpayers to conduct an analysis before entering into streamlined IAs and is placing taxpayers in IAs that they cannot afford. The consequences to the taxpayer and the IRS of placing taxpayers in unaffordable IAs include:

- Rework for the IRS when a taxpayer defaults;
- Wasted IRS resources;
- The inability of a taxpayer to qualify for another guaranteed IA in the subsequent five year period;<sup>9</sup> and
- An additional user fee for the taxpayer if the taxpayer requests a reinstatement of a defaulted IA.<sup>10</sup>

The IRS has the data available to determine if a taxpayer has the appropriate income to support payments under an IA and should use this data in making determinations about the taxpayer's ability to pay and appropriate collection alternatives for each taxpayer in order to prevent rework for the IRS, reduce burden and frustration for taxpayers, and craft individual taxpayer solutions that encourage current and future compliance.<sup>11</sup> As the IRS moves on its "Future State" plans, it should focus on using data and technology to assist taxpayers entering into realistic and affordable payment arrangements instead of relying upon a one-size-fits-all strategy.

## ANALYSIS OF PROBLEM

### Background

Taxpayers are required to pay their taxes throughout the year in a pay as they go fashion, either through income tax withholding from their paychecks or through quarterly estimated tax payments. However, in Tax Year 2015, the IRS received over 27 million returns with balances due; of those, over seven million did not include full payment with the return.<sup>12</sup> The IRS generally has ten years from the date

7 Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*. TAS research found 286,141 taxpayers who entered into an IA in 2014 despite TPI less than ALEs after eliminating accounts where abatements were at least half of the balance (including accruals), refund offsets that were at least 95 percent of the balance, or cases where the IRS classified a taxpayer prior to CNC subsequent to the initial TDA in 2014.

8 Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*. TAS research found that 42.8 percent of taxpayers with total positive income (TPI) less than their ALEs who had balances due of greater than \$10,000 and entered into IAs in FY 2014 defaulted by FY 2016.

9 IRM 5.14.11.5(2)(b) (Jan. 1, 2015).

10 IRM 5.19.1.5.4.6(4) (Sept. 29, 2014).

11 TAS, *Importance of Financial Analysis in Installment Agreements Research Study* (2016).

12 IRS, *Individual Returns Transaction File* (Dec. 20, 2016); IRS, *Compliance Data Warehouse* (Dec. 20, 2016).

**TAS research suggests that the IRS is placing taxpayers into Installment Agreements (IA) where their total positive income is less than their Allowable Living Expenses. Taxpayers may agree to an IA they can't afford out of fear of the IRS, a misunderstanding of the options available, or out of obligation to repay their debts at any costs.**

of assessment to collect the tax due — known as the collection statute expiration date (CSED).<sup>13</sup> There are a variety of payment options for taxpayers that depend on factors such as the amount owed and the taxpayer's compliance history.<sup>14</sup>

IAs are offered as a collection alternative mutually beneficial to taxpayers and the IRS — taxpayers can make payments to the IRS over time and spread out the burden of paying their tax accounts, and the IRS can increase revenue by collecting portions of tax due rather than nothing.<sup>15</sup> The IRS offers several types of IAs.<sup>16</sup> Congress has recognized the value of IAs, and in the IRS Restructuring and Reform Act of 1998 (RRA 98), it required the IRS to accept an IA proposal from a taxpayer if the taxpayer owed less than \$10,000, had not failed to file a required tax return in the previous five years, failed to pay any tax shown on such return or entered into an IA, could not full pay the liability when due, and would full pay the tax due within three years of the agreement.<sup>17</sup> This is known as a “guaranteed” IA.

Subsequently, the IRS administratively created a “streamlined” IA by increasing the limit of tax due allowed under “guaranteed” IAs and the length of time granted to the taxpayer to repay the debt.<sup>18</sup> Today, streamlined IAs are available to taxpayers with balances due of \$50,000 or less which will be repaid in installments in six years or less.<sup>19</sup> Other IAs, such as regular (non-streamlined) IAs and PPIAs require financial analysis and the completion of a Collection Information Statement (CIS) and generally require user fees and result in the filing of a Notice of Federal Tax Lien (NFTL).<sup>20</sup>

13 IRC § 6502(a).

14 See, e.g., IRC § 6159; IRC § 7122.

15 When a taxpayer enters into an IA, interest continues to accrue daily on the balance due from the due date of the first IA payment. IRC § 6601(b). A taxpayer who fails to pay the full balance due on the return is subject to the failure to pay (FTP) penalty under IRC § 6651 at a rate of 0.5 percent of the balance due per month or fraction of a month up to 25 percent of the total tax due. While the FTP penalty continues to accrue for the duration of an IA, Congress has encouraged the use of IAs by reducing the penalty to 0.25 percent per month or fraction of month on balances due where the taxpayer has entered into an IA. IRC § 6651(h).

16 IRM 5.14, *Installment Agreements* (Jan. 7, 2016).

17 IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3467, 112 Stat. 685 (1998) (codified at IRC § 6159(c)). This legislation codified the IRS's standard practice. Conf. Rep. No. 105-599, at 292-93 (1998). “Streamlined,” “guaranteed,” and “in-business trust fund express” IAs are all very similar and none of them require an analysis of the taxpayer's ability to pay. See IRM 5.14.5.1 (May 23, 2014).

18 See Memorandum from Assistant Commissioner (Collection), *Increase in Streamlined Installment Agreement Dollar Authority* (Mar. 31, 1998), reprinted as, *Memo on Streamlined Installment Agreements Released*, 1999 TNT 111-26 (June 10, 1999). See also IRM 5.14.2.2 (Oct. 18, 1999); Memorandum from Assistant Commissioner (Collection), *Increase in Streamlined Installment Agreement Authority* (Mar. 17, 1999), reprinted as, *Memo on Streamlined Installment Agreements Released*, 1999 TNT 111-24 (June 10, 1999). However, this guidance contemplated a conversation between the IRS and taxpayers. *Id.* (noting “[t]axpayers should be questioned on the amount they can pay every month...”).

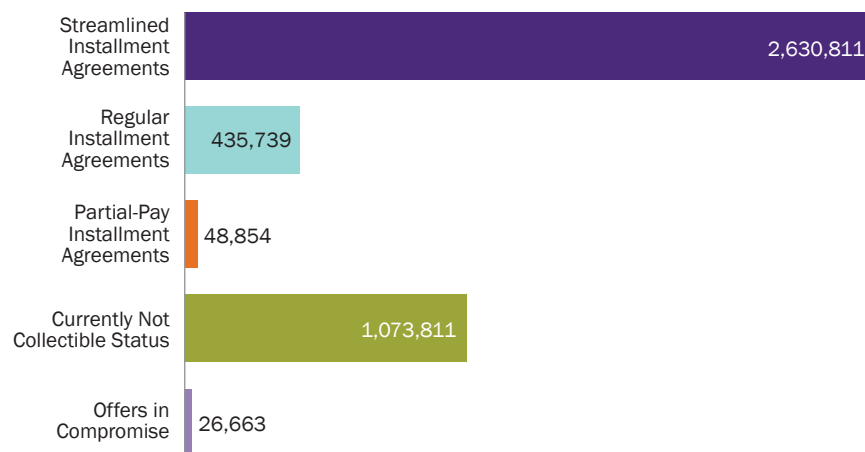
19 IRM 5.14.5, *Streamlined Installment Agreements* (Dec. 23, 2015).

20 IRM 5.14.1.2, *Installment Agreements and Taxpayer Rights* (Jan. 1, 2016). See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 403-25; National Taxpayer Advocate 2011 Annual Report to Congress 109-28; National Taxpayer Advocate 2010 Annual Report to Congress 302-10; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. See also Taxpayer Assistance Directives (TADs) 2010-1 and 2010-2 (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>. However, under IRC § 6323(j)(1)(B), the IRS may withdraw a Notice of Federal Tax Lien (NFTL) if the taxpayer enters into an IA, causing unnecessary burden and delay for the taxpayer to then request the withdrawal of an NFTL issued in concurrence with an IA.

The IRS granted over 3,000,000 IAs of all types in FY 2016.<sup>21</sup> This includes 2,630,811 streamlined IAs compared to 48,854 PPIAs, and 435,739 regular IAs.<sup>22</sup> In contrast, the IRS approved 26,663 offers in compromise (OICs) and placed 1,073,811 accounts into CNC status in FY 2016.<sup>23</sup> IAs, and in particular, streamlined IAs, are the most frequently used collection alternative at the IRS.

**FIGURE 1.17.1**

**Alternative Collection Arrangements in FY 2016**



**Allowable Living Expenses May Not Reflect the True Ability of Taxpayers to Make Installment Agreement Payments**

Expenses are allowable if they are “necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.”<sup>24</sup> IRC § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”<sup>25</sup> These ALEs are used to calculate a taxpayer’s ability to make IA payments. However, the standard of “necessary” is not defined in this context in the IRC or Treasury Regulations; instead, the IRS has determined what are “necessary” expenses using its own discretion. In fact, the Treasury Regulations relating to ALEs specifically state that taxpayers shall retain “sufficient” income to pay basic living expenses and this amount should be determined based on the individual taxpayer’s circumstances.<sup>26</sup>

ALEs are based on both national and localized costs using data from the Bureau of Labor Statistics and the Census Bureau.<sup>27</sup> Notably, ALEs have not been updated to include expenses that many families

21 IRS, Collection Activity Report 5000-6 (Oct. 3, 2016). The IRS granted 3,115,404 IAs of all types in FY 2016.

22 *Id.*

23 IRS, Collection Activity Reports 5000-108 (Oct. 4, 2016), 5000-149 (Oct. 3, 2016).

24 IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012). For a full discussion of the National Taxpayer Advocate’s concerns about ALEs, see Most Serious Problem: *The IRS Should Reevaluate How It Develops and Uses Allowable Living Expense (ALE) Standards to Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Household While Complying with Their Tax Obligations*, *supra*.

25 See also Treas. Reg. § 301.7122-1(c)(2)(i).

26 Treas. Reg. § 301.7122-1(c)(2)(i).

27 IRM 5.15.1.7 (Oct. 2, 2012).



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Nearly 300,000 taxpayer accounts that should have qualified for currently not collectible status ... (69 percent) are being resolved by the taxpayer making payments, not because of abatements by the IRS or offsets of the taxpayers' refunds, indicating that the taxpayers are paying their accounts despite having total positive income less than Allowable Living Expenses, suggesting the taxpayers are prioritizing paying the IRS over meeting their necessary living expenses.

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consider necessary to function in today's society. For example, the IRS considers childcare to be an "other expense" rather than a necessary expense, even where both parents are employed full time, thus leaving it to the determination of the individual IRS employee as to whether the expense will be considered necessary.<sup>28</sup> It would be counter-productive for this expense to be disallowed where both parents are working and would be better able to pay their tax liability with two incomes.<sup>29</sup>

TAS research suggests that the IRS is placing taxpayers into IAs where their total positive income (TPI) is less than their ALEs. Taxpayers may agree to an IA they can't afford out of fear of the IRS, a misunderstanding of the options available, or out of obligation to repay their debts at any costs. Nearly 300,000 taxpayer accounts that should have qualified for currently not collectible (CNC) status had entered into installment agreements in calendar year 2014 despite their income being below the IRS ALEs.<sup>30</sup> These taxpayer accounts (69 percent) are being resolved by the taxpayer making payments, not because of abatements by the IRS or offsets of the taxpayers' refunds, indicating that the taxpayers are paying their accounts despite having TPI less than ALEs, suggesting the taxpayers are prioritizing paying the IRS over meeting their necessary living expenses.<sup>31</sup> By the IRS's definition, taxpayers who cannot meet their necessary living expenses are experiencing economic hardship.<sup>32</sup> These taxpayers would therefore qualify for a mandatory release of an IRS levy, yet the IRS accepts IAs from these taxpayers despite the payments causing economic hardship.<sup>33</sup> Additionally, TAS research found higher default rates for taxpayers with TPI less than ALEs. Taxpayers with TPI less than ALEs and balances due of \$1,001 to \$10,000 who entered into IAs in FY 2014 defaulted at a rate of nearly 25 percent by FY 2016, compared to an overall default rate in this income category of less than 23 percent. Similarly, taxpayers with TPI less than ALEs and balances due of greater than \$10,000 who entered into IAs in FY 2014 defaulted at a rate of almost 43 percent by FY 2016 compared to an overall default rate in this category of less than 38 percent.<sup>34</sup>

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28 IRM 5.15.1.10(3), *Other Expenses* (Nov. 17, 2014).

29 The latest Census Bureau Report found that nearly 33 percent of children age five and under in 2011 were in non-relative care. Census Bureau, *Who's Minding the Children?* (Apr. 2013).

30 Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*. TAS research found 286,141 taxpayers who entered into an IA in 2014 despite TPI less than ALEs after eliminating accounts where abatements were at least half of the balance (including accruals), refund offsets that were at least 95 percent of the balance, or cases where the IRS classified a taxpayer prior to CNC subsequent to the initial TDA in 2014.

31 *Id.*

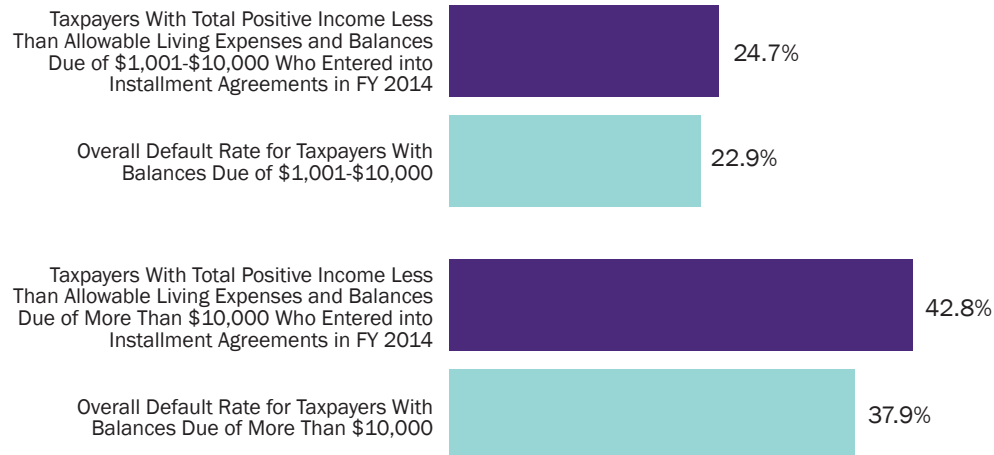
32 IRM 5.11.2.3.1.4, *Economic Hardship* (Apr. 15, 2014).

33 *Id.*

34 TAS, *Importance of Financial Analysis in Installment Agreements* (2016).

FIGURE 1.17.2

## Default Rates by Balance Due



## Certain Types of Installment Agreements Have Higher Rates of Default

*Taxpayer in PPIAs Default at a Higher Rate Than All Other Types of IAs*

The American Jobs Creation Act of 2004 amended IRC § 6159(a) to permit the IRS to accept IAs in full or partial collection of tax.<sup>35</sup> Such partial collection IAs, which will not full pay the tax liability before the statutory period for collection expires (referred to, in the IRS, as the collection statute expiration date or CSED), are known as PPIAs. The IRS may grant a PPIA where the taxpayer cannot full pay the liability before the CSED, but has some ability to pay.<sup>36</sup> In order to obtain a PPIA, the taxpayer must submit a full CIS in order for the IRS to assess ability to pay.<sup>37</sup>

Although IRS employees are required to determine ability to pay using the CIS, which relies on ALEs, PPIAs have a higher default rate than all other IA types.<sup>38</sup> PPIAs default at a rate of nearly 28 percent compared to 13 percent for all IAs.<sup>39</sup> By definition, these taxpayers are not able to full pay their liability in the IRS's determination. With such a high default rate, the financial analysis completed to determine the ability of the taxpayers under PPIAs to pay may not be capturing the true ability of these taxpayers to pay the amount determined. One factor that may contribute to this default rate is the disallowance of "conditional" expenses for PPIAs.<sup>40</sup> Taxpayers in regular IAs are allowed conditional expenses if they can full pay the liability in six years and within the CSED.<sup>41</sup> For example, education and legal fees (those not related to professional representation in matters before the IRS) are deemed conditional.<sup>42</sup> A taxpayer working towards completing a college degree would be required to stop attending classes which

35 The American Jobs Creation Act of 2004 (Pub.L. 108-357).

36 IRM 5.14.2.1 (Mar. 11, 2011).

37 IRM 5.14.2.1.1, *Streamlined Installment Agreement Requirements* (Sept. 19, 2014).

38 IRS, *IA Default Rate Report* (Oct. 6, 2016).

39 *Id.*

40 IRM 5.14.2.1.1 (Sept. 19, 2014).

41 IRM 5.19.13.1.2.7, *Conditional Expenses* (Nov. 25, 2014).

42 *Id.*

may trigger repayment requirements for student loans, further impacting the taxpayer's ability to pay. Or, if a taxpayer was involved in a custody suit over a minor child, legal fees would not be permitted. The taxpayer's custody suit would not go away as a result of a tax debt and the taxpayer would need to continue paying an attorney to proceed with the suit, possibly resulting in a default on the IA.

### *Taxpayers in IAs Worked by the Field or in ACS Default at Higher Rates Than Those Worked by Other Groups*

Most contact employees across the IRS can set up IAs with taxpayers; including employees in the Small Business/Self-Employed Division (SB/SE) Campus Collection Operations, ACS employees, Automated Collection System Support (ACSS) employees, Compliance Services Collection Operations (CSCO) employees, as well as Collection Field function Revenue Officers & Taxpayer Assistance Center (TACs) employees, and Tax Compliance Officers and Revenue Agents in the Examination Division, who can set up IAs at the completion of an audit as well as Wage and Investment (W&I) employees who answer the National Taxpayer Advocate Toll-Free Line.<sup>43</sup> In TAS, Intake Advocates and Case Advocates as well as Customer Service Representatives also have the delegated authority to set up streamlined IAs.<sup>44</sup>

Field and ACS worked IAs have higher default rates than all IAs overall and higher default rates than IAs worked by other IRS work groups.<sup>45</sup> Field IAs default at a rate of 26 percent and ACS IAs at a rate of 20 percent. This is in comparison to an overall IA default rate of 13 percent, a default rate of only about nine percent for CSCO, and a rate of 11 percent for Exam-worked IAs.<sup>46</sup>

The disparate default rates for IAs worked by different IRS work groups should be studied. The IRS may find that the taxpayer populations served by different IRS working groups have unique characteristics and needs. Such information would allow the IRS to tailor training on all alternative collection methods to the particular working group and taxpayer populations served and potentially increase collectibility.<sup>47</sup>

### *The IRS Needs to Focus on Realistic and Affordable Resolution of a Tax Account Based on a Thorough Financial Analysis of the Taxpayer's Ability to Pay Upfront*

The goal of an IA should be to create a payment plan that is realistic for the taxpayer given the taxpayer's individual circumstances. If an IA is not the best solution for the taxpayer and the IRS, alternatives such as OICs should be explored. For example, field employees may work with more noncompliant taxpayers where special strategies are needed to ensure that the taxpayers come into and remain in compliance throughout the IA process. Developing training aimed at creating strategies to address the issues in these taxpayer populations may assist these employees in crafting IAs that will help these taxpayers remain compliant or in placing the taxpayer in a different, more suitable collection arrangement given the circumstances, such as an OIC.

43 IRS, *Streamlined Processing of Installment Agreements*, <https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements> (last visited Dec. 20, 2016).

44 IRM 13.1.4.2.3.9 (Oct. 31, 2004). See also TAS, *Authority of Taxpayer Advocate Service Employees to Perform Certain Tax Administration Functions* (July 27, 2015).

45 IRS, *IA Default Rate Report* (Oct. 6, 2016).

46 *Id.*

47 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 37 (Research Study: *IRS Collectibility Curve*).

Congress has long viewed the OIC as a viable collection alternative to bring taxpayers back into compliance, writing in the RRA 98 Conference Report:

The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.<sup>48</sup>

Proper financial analysis upfront may point to the OIC being a better option than a lengthy IA such as an extended six-year IA or a PPIA. Additionally, an OIC has the added benefit of bringing finality to the taxpayer and the IRS as requiring five years of tax compliance from the taxpayer.<sup>49</sup> When taxpayers default on IAs, it results in an endless cycle of IRS rework and taxpayer burden, which could be avoided if the IRS used the data it has available prior to accepting an IA and only placed those taxpayers with demonstrated ability to pay in IAs

Training on IAs, ALEs, and alternative collection solutions should be developed based on specific taxpayer populations and delivered to these employees. Focusing on determining the ability to pay, and ensuring that employees allow all necessary expenses when determining the payment amount for the IA may help create IAs that these taxpayers can afford. As a general policy, the IRS should not accept IAs that cause economic hardship. It could avoid this result by developing a screening algorithm that will identify when a taxpayer's income is less than his or her ALEs. In order to prevent creating economic hardship in such cases, the IRS would be required to pursue alternate collection solutions crafted to the taxpayer's unique circumstances, including CNC-hardship or an OIC.<sup>50</sup> All IRS employees authorized to enter into IAs should utilize this filter, and it should be incorporated into the online IA tool on irs.gov.

## CONCLUSION

Taxpayers who enter into IAs they cannot afford risk defaulting on the agreement and being subject to further collection efforts. Alternatively, they may attempt to pay the IRS at the expense of meeting their basic living needs. Further compounding this problem are ALEs where the analysis leaves major household expenses up to the individual discretion of an IRS employee and ALEs that are based on standard expenses that do not reflect the reality of today's society. Setting taxpayers up to fail at compliance does not comport with taxpayers' rights, specifically the *right to finality* and *the right to a fair and just tax system*. More comprehensive financial analysis, including the development of an ability-to-pay estimator that uses the taxpayer's most recent income data, revised and updated ALEs, expanded use of OICs, and targeted employee training will assist the IRS and taxpayers in ensuring the success of IAs and the compliance of taxpayers who enter into IAs.

48 H.R. REP. NO. 105-599, at 288-89 (1998) (Conf. Rep.).

49 IRS, *Form 656 Offer in Compromise* (Feb. 2016).

50 IRM 5.11.2.3.1.4, *Economic Hardship* (Apr. 15, 2014).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Modify the ALEs in accordance with the recommendations in the Most Serious Problem on ALEs.
2. Develop an internal ability-to-pay estimator that will populate with the most current taxpayer income information for use by all employees offering IAs.
3. Revise IRMs and employee training to require use of the estimator even in streamlined IA applications and provide employees with a decision tree indicating where other collection alternatives are more appropriate than IAs.

**MSP  
#18****INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): IRS  
Processes for ITIN Applications, Deactivations, and Renewals  
Unduly Burden and Harm Taxpayers****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

Each year, approximately 4.6 million taxpayers ineligible for Social Security numbers (SSNs) require Individual Taxpayer Identification Numbers (ITINs) to comply with their tax filing and payment obligations, claim dependents, and receive tax benefits.<sup>2</sup> Foreign taxpayers rely on ITINs to avoid mandatory withholding on some types of U.S. source income<sup>3</sup> and upon the disposition of U.S. real property interests,<sup>4</sup> or to meet the requirements of third parties such as banks, who request ITINs for information reporting and withholding purposes.<sup>5</sup> Failure to timely obtain an ITIN can lead to harsh financial consequences such as late filing penalties, higher withholding, and the permanent loss of certain tax credits.

Changes in application requirements, program administration, and insufficient staffing have contributed to delays in obtaining ITINs for thousands of taxpayers.<sup>6</sup> During the busiest time of the 2016 filing season, the average weekly inventory of unassigned ITIN applications with tax returns was nearly 80,000, reflecting a significant backlog.<sup>7</sup> ITIN applications and associated return filings have dropped

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See, e.g., IRC § 24(e). For detailed characteristics of Individual Taxpayer Identification Number (ITIN) applicants in recent years, see National Taxpayer Advocate 2015 Annual Report to Congress 198-200.

3 Chapter 3 of the Code generally requires withholding agents to collect the substantive tax liability of nonresident aliens imposed under IRC §§ 871(a), 881(a), and 4948 by withholding on certain payments of U.S. source fixed or determinable annual or periodical income. See IRC §§ 1441-1443. See also IRC §§ 1471-1474 (Chapter 4).

4 Foreign Investment in Real Property Tax Act (FIRPTA) of 1980, Pub. L. No. 96-499, Subtitle C, 94 Stat. 2599, 2682 (1980).

5 See IRC § 6041.

6 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 196, 202; National Taxpayer Advocate 2013 Annual Report to Congress 214, 221.

7 IRS, *ITIN Production Reports* (March 5, 2016 through June 11, 2016).



62.5 percent between 2011 and 2015,<sup>8</sup> suggesting some taxpayers may have stopped filing returns due in part to the difficulty of obtaining an ITIN.

The Protecting Americans from Tax Hikes (PATH) Act of 2015, signed into law in late 2015, made significant changes to the ITIN program, while codifying some existing administrative procedures.<sup>9</sup> The law includes positive changes, such as expanding the Certified Acceptance Agent (CAA) program<sup>10</sup> and requiring the IRS to study the ITIN application process. However, it creates significant challenges for the IRS, such as the rigid schedule for deactivating millions of ITINs. Some provisions, such as the requirement for an ITIN to be issued by the tax return due date in order to receive the Child Tax Credit (CTC) or American Opportunity Tax Credit (AOTC), could have devastating consequences. The National Taxpayer Advocate is concerned that:

- The IRS's deactivation plans have the potential to create confusion and result in taxpayers not renewing their ITINs in time to file returns timely;
- The IRS has not exercised the flexibility the PATH Act grants for acceptable documentation, thereby leaving a significant number of applicants needing to mail original documents to the IRS;
- Math error procedures for taxpayers whose ITIN applications are rejected or whose ITINs are deactivated infringe on taxpayer rights;
- Taxpayers may not receive the CTC or the AOTC if they do not know to file timely, or if the IRS mishandles or loses their returns; and
- The general requirement for new ITIN applicants to apply during the filing season burdens applicants, creates delays, hampers fraud detection, and exacerbates the other problems ITIN applicants face.

## ANALYSIS OF PROBLEM

### Background

#### *Purpose of ITINs*

Any person required to file a tax return, statement, or other document must include a taxpayer identifying number (TIN).<sup>11</sup> A person must also provide his or her TIN to a third party if the IRS requires the third party to include the person's TIN on a return or document.<sup>12</sup> In 1996, the IRS created ITINs to help taxpayers who need a TIN to comply with the law, but who are ineligible for an SSN.<sup>13</sup> ITINs are "important for the effective operation of the IRS automatic data processing system."<sup>14</sup>

8 In processing year (PY) 2011, 2,317,374 ITIN applications (Forms W-7) were received compared to 869,575 in PY 2015. IRS, ITIN Comparative Reports (Dec. 31, 2011) and (Dec. 30, 2015), respectively.

9 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV (2015) (hereinafter PATH Act).

10 Certified Acceptance Agents (CAAs) were previously referred to and at times still referred to as "Certifying Acceptance Agents" by the IRS. See, e.g., Internal Revenue Manual (IRM) 3.21.263.3.1, *Acceptance Agent (AA) or Certifying Acceptance Agent (CAA)* (Sept. 12, 2016).

11 IRC § 6109(a)(1); Treas. Reg. § 301.6109-1(b).

12 IRC § 6109(a)(2); Treas. Reg. § 301.6109-1(c).

13 Taxpayer Identifying Numbers (TINs), 61 Fed. Reg. 26788 (May 29, 1996) (codified at Treas. Reg. § 301.6109-1).

14 ITINs "improv[e] the IRS' ability to identify and access database records; to match information provided on tax and information returns, statements, and other documents with the proper taxpayers; and to provide better customer service to taxpayers." Taxpayer Identifying Numbers (TIN), 60 Fed. Reg. 30211, 30212 (proposed June 8, 1995) (codified at Treas. Reg. § 301.6109-1).

All United States (U.S.) citizens and persons considered U.S. residents under the Internal Revenue Code (IRC) are required to file and pay U.S. taxes on their worldwide income and need a TIN to do so.<sup>15</sup> Under the IRC, an individual is a resident for tax purposes if he or she is a lawful permanent resident, which is consistent with immigration law.<sup>16</sup> However, an individual is also a resident for tax purposes if he or she is present in the United States a minimum number of days, regardless of immigration status,<sup>17</sup> which creates a tension between tax law and immigration law. In these cases, it is especially important for the IRS to protect a taxpayer's *right to confidentiality*, which generally prohibits the IRS from sharing any taxpayer information with the Department of Homeland Security.<sup>18</sup> If the IRS fails to protect this right, taxpayers may stop filing and paying their taxes out of fear of deportation. The IRS has been able to navigate the difficult balance between the tax law and immigration law through the ITIN program, and the National Taxpayer Advocate believes that any disruption of this balance will undermine voluntary compliance.

### *Overview of the PATH Act ITIN Changes*

The PATH Act establishes requirements for how taxpayers apply for ITINs, what documentation is required, how long an ITIN is effective, how the IRS treats deactivated ITINs, and when an ITIN must be issued to receive certain tax credits. Applicants residing in the United States can apply in person to an IRS employee or CAA, or by mail.<sup>19</sup> Applicants abroad can no longer use a CAA, but can now apply in person to a designated official at a U.S. diplomatic mission or consular post.<sup>20</sup> Applicants must submit documentation to prove identity, residency, and foreign status.<sup>21</sup> The IRS may only accept original documents or “certified copies meeting the requirements of the Secretary,” which allows the IRS to decide what constitutes a certified copy and who can certify copies of which documents.<sup>22</sup> The law envisions an expansion of the CAA program, allowing state and local governments, federal agencies, and others authorized by the IRS to be CAAs.<sup>23</sup>

The PATH Act will create challenges for taxpayers and the IRS. Under the law, all ITINs issued after 2012 will remain in effect unless the ITIN holder does not file a tax return with the ITIN, or is not

15 See, e.g., IRC § 61. Individuals considered nonresident aliens under the IRC are required to file and pay tax on income derived from sources within the United States. See IRC §§ 1, 2, 871, 7701(b).

16 IRC § 7701(b)(1)(A)(i).

17 To become a resident for tax purposes, an individual must be generally present in the U.S. on at least 183 days during a three year period that includes the current year. See *generally* IRC § 7701(b); Treas. Reg. § 301.7701(b)-1(c).

18 See IRC § 6103. There is a limited exception for sharing information related to criminal or terrorist activities, or emergency circumstances. IRC § 6103(i)(3).

19 PATH Act, § 203(a) (codified at IRC § 6109(i)(1)(A)). This section codifies prior administrative policy.

20 PATH Act, § 203(a) (codified at IRC § 6109(i)(1)(B)). Congress has introduced legislation to clarify that CAAs are available for ITIN applicants outside the United States. See Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(1) (2016); H.R. 4891, 114th Cong. § 2(e)(1) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(2) (2016); H.R. 6439, 114th Cong. § 101(f)(2) (2016).

21 PATH Act, § 203(a) (codified at IRC § 6109(i)(2)(A)).

22 PATH Act, § 203(a) (codified at IRC § 6109(i)(2)(B)).

23 PATH Act, § 203(c). As part of a required study, the IRS must evaluate ways to expand CAA availability and participation. PATH Act, § 203(d).

included on another's return as a dependent for three consecutive taxable years.<sup>24</sup> ITINs issued before 2013 will expire at the earlier of:

- After a period of three consecutive years of nonuse (defined above), with the first deactivations required to have begun the last day of 2015; or
- On the “applicable date” scheduled between 2017 and 2020.<sup>25</sup>

The National Taxpayer Advocate has long advocated for the IRS to deactivate ITINs no longer used for tax administration purposes.<sup>26</sup> However, attempts to expedite the deactivations before proper systems are in place could harm taxpayers. Other PATH Act provisions that will harm taxpayers include the law's extension of math error authority<sup>27</sup> to situations where the taxpayer uses a deactivated ITIN on his or her return,<sup>28</sup> and the prohibition on claiming the CTC and the AOTC if the taxpayer's ITIN was issued after the due date for filing the tax return for the taxable year.<sup>29</sup>

### *Overview of IRS Changes in Response to the PATH Act*

In response to the PATH Act, the IRS has made significant changes to the ITIN program. For example, the IRS has restricted which passports can qualify as stand-alone documents for dependents<sup>30</sup> and has created a list of secondary documents that can be submitted with a passport, which includes identification documents not previously considered.<sup>31</sup> As discussed below, some of the IRS's changes either partially or fully implement prior National Taxpayer Advocate recommendations.

### *Changes to the Certified Acceptance Agent (CAA) Program*

The National Taxpayer Advocate called attention to the IRS's unreasonably short application season for CAAs, and the IRS announced it will accept CAA applications year round.<sup>32</sup> The National Taxpayer Advocate has repeatedly recommended that CAAs be allowed to certify documents for dependents.<sup>33</sup> Although the IRS did not adopt this recommendation fully, it agreed to allow CAAs to review two types of documents for dependents.<sup>34</sup> The National Taxpayer Advocate has also encouraged the IRS to solicit

24 PATH Act § 203(a) (codified at IRC § 6109(i)(3)(A)). The PATH Act § 203(f) provides that the amendments made in § 203 only apply to ITIN applications made after the effective date for the legislation. Congress has introduced legislation to clarify, among other items, that the effective date provision in § 203(f) does not apply to the provisions regarding already issued ITINs. Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(3) (2016); H.R. 4891, 114th Cong. § 2(e)(3) (2016). Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(5) (2016); H.R. 6439, 114th Cong. § 101(f)(5) (2016).

25 PATH Act § 203(a) (codified at IRC § 6109(i)(3)(B)). But see PATH Act § 203(f), which provides the amendments in § 203 only apply to ITIN applications made after the effective date.

26 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 334.

27 The IRS is currently authorized to correct mathematical or clerical errors — arithmetic mistakes and the like — and assess any tax increase using summary assessment procedures that do not provide the taxpayer an opportunity to challenge the proposed deficiency in the United States Tax Court before the tax is assessed. See IRC §§ 6213(b)(1), (g)(2).

28 PATH Act § 203(e) (codified at IRC § 6213(g)(2)).

29 PATH Act §§ 205, 206 (codified at IRC §§ 24(e), 25A(i)(6)).

30 “Beginning Oct. 1, 2016, the IRS will no longer accept passports that do not have a date of entry into the U.S. as a stand-alone identification document for dependents from countries other than Canada or Mexico or dependents of military members overseas.” IRS Works to Help Taxpayers Affected by ITIN Changes; Renewals Begin in October, IR-2016-100 (Aug. 4, 2016).

31 If the passport lacks a date of entry, applicants can provide U.S. school records or if over 18 years old, a rental or bank statement or a utility bill (with the applicant's name and U.S. address). *Id.*

32 See National Taxpayer Advocate Fiscal Year (FY) 2017 Objectives Report to Congress 152; IRS, New ITIN Acceptance Agent Program Changes, <https://www.irs.gov/individuals/new-itin-acceptance-agent-program-changes> (last updated Oct. 3, 2016).

33 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 196, 212.

34 CAAs can now review birth certificates and passports for dependents. IRS, *New ITIN Acceptance Agent Program Changes*, <https://www.irs.gov/individuals/new-itin-acceptance-agent-program-changes> (last updated Oct. 3, 2016).

comments regarding expansions to the CAA program,<sup>35</sup> and the IRS recently sought public comments on CAA eligibility and ways to increase participation.<sup>36</sup>

### *Implementation of a Deactivation Program*

The IRS has initiated a deactivation and renewal program for ITINs. The agency faces barriers to deactivating the volume of ITINs required within the timeframe specified in the PATH Act and has come up with an alternative plan. Accordingly, all ITINs that have not been used in the last three years will be deactivated at the start of 2017, regardless of when they were issued.<sup>37</sup> ITINs issued prior to 2013 that have been used in the last three years will be deactivated on a rolling basis, starting with ITINs with the middle digits 78 and 79, which the IRS issued between 1996 and 2000.<sup>38</sup> Only taxpayers who have filed in the last three years will receive a letter telling them to renew.

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**Of the approximately 11 million Individual Taxpayer Identification Numbers (ITINs) planned to be deactivated in January 2017, the IRS only sent letters to 440,000 taxpayers whose ITINs were used on a return during the last three years, telling them they need to renew.**

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Applicants needing to renew their ITINs were able to file renewal applications starting October 1, 2016.<sup>39</sup> Unlike most new ITIN applications, renewal applications can be submitted without a tax return.<sup>40</sup> The IRS accepts ITIN applications during the renewal period from all family members claimed on the return so long as at least one family member needs to renew due to having the numbers 78 or 79. During the renewal period, identification documents will be returned within 60 days.<sup>41</sup> Although the IRS will acknowledge receipt of the ITIN application and identification documents, the renewal application cannot be approved and the ITIN reissued until early 2017 because of the time required to reprogram the necessary databases and systems.<sup>42</sup>

The National Taxpayer Advocate expressed concern about the need for formal IRS guidance regarding the consequences of using a deactivated ITIN on a third-party information return.<sup>43</sup> For these returns, examples of which include Forms 1099-INT (used to report interest income) and 1099-DIV (used to report dividends and stock distributions), the third-party financial institution may require the taxpayer to provide a TIN to open the account, even though the taxpayer may not have a U.S. return filing requirement. The IRS has now clarified that taxpayers with ITINs that have expired according to the PATH Act but are only being used on information returns filed by third parties do not need to renew their ITINs unless they need to

35 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 151.

36 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

37 IRS response to TAS Information request (Nov. 29, 2016).

38 The IRS's approach is to start deactivating ITINs with the oldest issuance dates, determined by the middle two digits of the ITIN. The IRS limited deactivations to these groups of ITINs "due to a lack of the necessary resources to service requests for ITIN renewals for the impacted population of approximately 20 million users." IRS response to TAS Information request (Nov. 29, 2016).

39 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

40 Following the National Taxpayer Advocate's objections to the IRS requiring renewal applications to be submitted with a tax return, the IRS agreed to allow all renewal applicants (including those who had not filed a tax return in the last three years) to apply for renewal without submitting a tax return and outside of the filing season. See National Taxpayer Advocate comments on Notice 2016-48, *Implementation of PATH Act ITIN Provisions* (July 26, 2016); email from Debra Holland, Commissioner, Wage & Investment Division (W&I) to National Taxpayer Advocate (July 28, 2016) (on file with TAS).

41 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

42 Conference call between TAS and W&I (Oct. 3, 2016); IRS Response to TAS information request (Nov. 29, 2016); IRS response to TAS fact check (Dec. 20, 2016).

43 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 158-59.

file an individual return.<sup>44</sup> Further, the IRS will not penalize third parties under IRC §§ 6721 and 6722 solely because they have listed an expired ITIN on an information return.<sup>45</sup>

### *Requirement for Claiming the Child Tax Credit (CTC) or American Opportunity Tax Credit (AOTC) With an ITIN*

The National Taxpayer Advocate has also expressed concerns about how the IRS will implement § 205 of the PATH Act, which requires an ITIN to be issued before the tax return due date in order to receive the CTC or AOTC. The IRS announced “[t]he issuance date of a renewed ITIN is the date the ITIN was originally issued, not the renewal date.”<sup>46</sup> Thus, § 205 should have no effect on renewal applicants. For new ITIN applicants, starting March 14, 2017, when programming changes are in place, the ITIN will be deemed to be issued on the date the ITIN application and associated tax return (if attached) are received.<sup>47</sup> As long as the applicant timely files and is otherwise entitled to the credits, a delay in processing the ITIN should not prevent the applicant from receiving the CTC or AOTC per § 205.

### **The IRS’s Deactivation Plans Will Create Taxpayer Confusion and Lead to Taxpayers Not Renewing Their ITINs in Time to File Returns Timely**

Although tying the deactivation to the middle digits of the ITIN provides simplicity for taxpayers, the National Taxpayer Advocate is concerned some taxpayers will not be notified that their ITINs will expire and others may be confused about the status of their deactivated ITINs that are still being used on third-party information returns. Of the approximately 11 million ITINs planned to be deactivated in January 2017, the IRS only sent letters to 440,000 taxpayers whose ITINs were used on a return during the last three years, telling them they need to renew.<sup>48</sup> The IRS identified 440,000 taxpayers whose ITINs were used recently and sent approximately 309,000 letters, taking into account that some households have multiple ITIN holders with the digits 78 or 79, and sending only one letter to each household.<sup>49</sup>

The IRS’s decision not to notify taxpayers who did not file a return in the last three years impairs a taxpayer’s *right to be informed* by excluding those who temporarily had no filing requirement.<sup>50</sup> Taxpayers required to renew who did not receive a letter may be confused about whether their ITINs are expiring and if they must wait until the filing season to apply for an ITIN with a tax return (which

44 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

45 *Id.*

46 *Id.*

47 Under the current procedure for new applications, an ITIN is deemed to be issued on the date the ITIN is assigned. IRS response to TAS information request (Nov. 29, 2016); IRS response to TAS fact check (Dec. 20, 2016).

48 “The 11 million ITINs deactivating in January represent ITINs not present on a tax return at least once in the last three consecutive tax years. Approximately 440,000 ITINs have the middle digits 78/79 and have been used on a tax return within the last three consecutive tax years.” IRS response to TAS fact check (Dec. 20, 2016). See also IRS response to TAS information request (Nov. 29, 2016). As of September 13, 2016, the IRS has issued 273,000 (of an anticipated 309,000 letters). IRS internal communication, *IRS Announces Important Individual Tax Identification Number Program Changes* (Sep. 19, 2016) (on file with TAS), <http://win.web.irs.gov/articles/2016/ITIN-policy-changes.htm>.

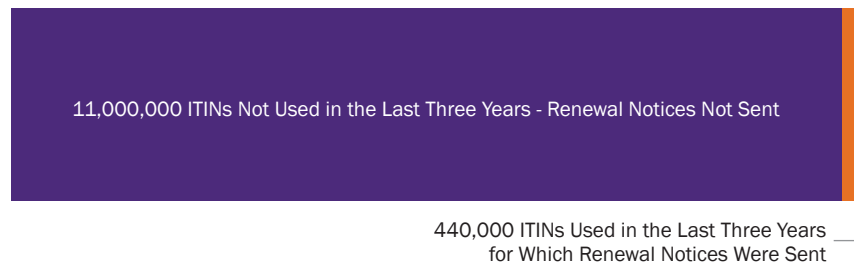
49 IRS response to TAS information request (Nov. 29, 2016); IRS response to TAS fact check (Dec. 20, 2016).

50 The IRS anticipates more than 300,000 of the approximately 11 million ITIN holders subject to deactivation who have not filed a return in the past three years to apply for renewal in 2017. IRS response to TAS information request (Nov. 29, 2016).

is unnecessary).<sup>51</sup> As shown in Figure 1.18.1, the IRS attempted to notify by mail only 4 percent of taxpayers whose ITINs the IRS will deactivate on January 1, 2017.<sup>52</sup>

**FIGURE 1.18.1**

**ITINs to Be Deactivated in 2017; Limited Renewal Notices**



The response rate to the ITIN renewal letters has been only 16 percent, despite the IRS's expectation that all of the approximately 440,000 ITIN holders subject to deactivation who filed a return in the last three years will be renewing their ITINs.<sup>53</sup> This low rate indicates the IRS's communication strategy has not been effective in reaching the taxpayers who need to renew early.<sup>54</sup>

Another major issue is the length of time between when a renewal application is filed (starting October 1, 2016) and when a renewal request is processed and an ITIN issued (beginning January 3, 2017).<sup>55</sup> During this period, the IRS inspects and returns the original documents (corresponding if the application or documents were deemed insufficient),<sup>56</sup> and promises to notify taxpayers if they may use their ITINs at a date in the future, no earlier than February 21, 2017.<sup>57</sup> The IRS is unable to process the actual

51 See Instructions for Form W-7, 4 (Sept. 2016).

52 See IRS response to TAS information request (Nov. 29, 2016). The 440,000 ITINs comprise those with middle digits 78 and 79 that have been used within the last three tax years; the approximate 11 million ITINs comprise all ITINs that have not been used within the last three tax years. The IRS sent a renewal notice to the primary taxpayer if any of the ITINs listed on that taxpayer's prior returns are one of the 440,000 recently used. Because multiple such ITINs may have been listed on a single taxpayer's return, the IRS only sent one notice to each primary taxpayer, which resulted in 309,000 notices being sent.

53 *Id.* When told by a reporter that the response rate to the letters telling ITIN holders to renew was 16 percent, the IRS Commissioner said it did not surprise the IRS. *Tax Analysts Exclusive: Conversations: Koskinen Looks to Future of Tax Administration, IRS Budget*, 2016 TNT 240-2, TAX NOTES TODAY (Dec. 14, 2016). The IRS later told TAS it expects the entire population of approximately 450,000 ITIN holders with middle digits 78 and 79, who have filed a return in the past three years, to renew their ITINs. Email from W&I to TAS (Dec. 1, 2016) (on file with TAS). *Id.*

54 See David van den Berg, *Taxpayer Response to ITIN Expiration Letters is Slow So Far*, 2016 TNT 241-5, TAX NOTES TODAY (Dec. 15, 2016) ("Most ITIN renewal applications will occur during and after tax season, which will cause significant delays for much-needed tax refunds for already cash-flow-challenged working families." (quoting Francine Lipman, William S. Boyd Professor of Law, University of Nevada, Las Vegas)).

55 See Letter 5872 (Sep. 2016), Internal Management Document (IMD) review 3607.

56 During this time, "[c]orrespondence may be sent to the applicant when the Form W-7 and/or submitted documents are insufficient to successfully renew the ITIN. In addition, the Form W-7 and identification document information is captured into a simulated database. In January 2017, [the IRS] will begin transferring the data from the simulated database into the ITIN-RTS [Real Time] system to begin processing the renewal applications in order of receipt." IRS response to TAS fact check (Dec. 20, 2016). The IRS sent notices to approximately 23,000 renewal applicants whose applications were insufficiently documented or complete. IRS, *ITIN Production Report* (Dec. 17, 2016).

57 The IRS will notify taxpayers of their ITIN application status seven weeks (nine to eleven weeks if application is submitted during the filing season or from overseas) from January 3, 2017 or from the mailing date of the ITIN application, whichever is later. IRS response to TAS fact check (Dec. 20, 2016); Letter 5872 (Sept. 2016).



applications until early 2017 because it did not have sufficient time to reprogram the required databases and systems.<sup>58</sup> If taxpayers change addresses during this time, it could lead to them failing to receive their ITIN notifications, or worse, their identities being stolen if they no longer reside at the address where the notification is sent. Taxpayers who do not receive a notification will create more work for the IRS in the form of phone calls to find out if an ITIN has been processed.

For taxpayers with deactivated ITINs that are still being used on third-party information returns, there may be confusion when they need to file an individual return. If they have not filed an individual return or been included as a dependent on one in the last three years, these taxpayers will not be notified that their ITINs have expired and may mistakenly believe their ITINs are still valid because they are actively being used.

Another issue is the treatment of ITINs that have expired under the law, but which have not been deactivated by the IRS. The PATH Act provides that ITINs issued prior to 2008 will no longer be in effect,<sup>59</sup> but the IRS is only deactivating ITINs that have not been used in the last three years or contain the middle digits 78 or 79 (issued between 1996 and 2000).<sup>60</sup> Thus, ITINs issued after this time but prior to 2008 that have been used in the last three years will expire under the law on January 1, 2017, but not be deactivated by the IRS at this time.

**FIGURE 1.18.2, ITINs Requiring Deactivation under the PATH Act, ITINs Planned to be Deactivated by the IRS in 2017<sup>61</sup>**

#### PATH Act Requires Deactivation of 20 Million ITINs



20 Million ITINs That Have Expired Or Will Expire by January 1, 2020 Under the PATH Act

Although presumably the IRS will process a return filed with such an ITIN as if the ITIN is currently valid, a problem could arise if the IRS disallows or adjusts items on the return, and the taxpayer wishes to challenge the disallowance in court. If the ITIN had expired under the law, the Court would have to disallow any exemptions or credits for which an ITIN is required, even if the IRS had told the taxpayer the ITIN was valid and they did not need to renew.<sup>62</sup> Having the systems in place to allow all applicants

58 IRS response to TAS information request (Nov. 29, 2016).

59 PATH Act § 203(a) (codified at IRC § 6109(i)(3)(B)). But see PATH Act § 203(f), which provides the amendments in § 203 only apply to ITIN applications made after the effective date.

60 IRS response to TAS information request (Nov. 29, 2016).

61 See IRS response to TAS information request (Nov. 29, 2016). “We estimate we will expire more than 11 million ITINs in January 2017, all of the unused ITINs as well as those with middle digits of 78 and 79 that are still in use.” The IRS estimates an “impacted population of approximately 20 million.” *Id.*

62 In this scenario, the Tax Court would have to have knowledge of the ITIN's issuance date in order to determine when the ITIN expired under the law. The IRS maintains information regarding the ITIN date of issuance on its internal system, the ITIN Real Time System. IRM 3.21.263.1, *Overview* (Oct. 4, 2016). A Taxpayer Identification Number (TIN) is required to claim a personal exemption for the taxpayer, taxpayer's spouse, or a dependent, and to claim the Child Tax Credit. See IRC §§ 151(e), 24(e).

to renew their ITINs, even if there was no impending deactivation for those ITINs by the IRS, would mitigate this problem, but not fully solve it.<sup>63</sup>

### The IRS Has Not Exercised the Flexibility the PATH Act Grants for Acceptable Documentation, Thereby Leaving a Significant Number of Applicants Needing to Mail Original Documents to the IRS

Although the IRS has finally permitted CAAs to review passports and birth certificates for dependents,<sup>64</sup> many dependents may still need to mail in their original documents. As shown in the table below, a significant number of dependents need to use other identification documents.

**FIGURE 1.18.3, Most Common Dependent Documents Submitted With ITIN Applications during Processing Years 2015 and 2016<sup>65</sup>**

| Type of Identification Document  | December 31, 2015 | September 30, 2016 |
|----------------------------------|-------------------|--------------------|
| Civil Birth Certificate          | 180,297           | 73,366             |
| Passport                         | 175,957           | 70,042             |
| School Records                   | 81,139            | 31,933             |
| Medical Records                  | 52,924            | 20,163             |
| Foreign Voters Registration Card | 34,781            | 16,438             |

The PATH Act gives the IRS latitude to provide alternatives to accepting only original documents or copies certified by the issuing agency.<sup>66</sup> In addition to allowing CAAs and Taxpayer Assistance Centers (TACs) to certify all identification documents for all applicants,<sup>67</sup> the IRS could determine other types of documents also meet the requirements of a “certified copy.”<sup>68</sup> Yet, the IRS has failed to exercise this discretion and has not identified additional types of certified copies. Furthermore, the IRS should consider accepting notarized copies as certified copies when from specific jurisdictions where a notary is considered a public officer and is authorized to verify the content of documents.<sup>69</sup>

63 See Legislative Recommendation: *Individual Taxpayer Identification Numbers (ITINs): Amend the Protecting Americans from Tax Hikes (PATH) Act of 2015 to Revise the Expiration Schedule for ITINs*, *infra*.

64 See Instructions for Form W-7 (Sept. 2016).

65 IRS Response to TAS information request (Nov. 29, 2016) (citing the Compliance Data Warehouse (CDW) Tables Form\_W7, Form\_W7\_VISA, retrieved Oct. 27, 2016). The IRS acknowledges this data may be incomplete. *Id*.

66 See IRC § 6109(i)(2)(B)).

67 In late 2016, the IRS expanded the list of documents a TAC can certify for primary or secondary taxpayers to 11 documents. For dependents, TACs can only certify three types of documents. There are currently 179 TACS that can verify ITIN documents. IRS response to TAS information request (Nov. 29, 2016). CAAs can only verify passports and birth certificates for dependents. Instructions for Form W-7 (Sept. 2016).

68 For example, copies could be certified by state or other Federal agencies other than the issuing agency or clerks of courts, and or copies could be properly apostilled and authenticated by U.S. diplomatic missions abroad. See U.S. Department of State, Authentications and Apostilles, <http://travel.state.gov/content/travel/en/legal-considerations/judicial/authentication-of-documents/notarial-and-authentication-apostille.html> (last visited on Sep. 26, 2016).

69 For example, in France, a notary is a public officer, acting on behalf of the State, appointed by the Minister of Justice. He or she authenticates instruments, which includes a guarantee as to the content and date of the instrument, giving the instrument the legal status of a final judgment. Notaires de France, *The role of the Notaire*, <http://www.notaires.fr/en/role-notaire> (last visited Oct. 26, 2016).

Due to the lack of free and accessible alternatives, including TACs,<sup>70</sup> some applicants may still have to mail in original documents. As one taxpayer explains:

So, imagine if I take your wallet and I put it in the postal box and say, “Hey, wait, it’s going to come back to you.” It’s the same when the IRS tells them, “I’m sending it back to you,” but you’re going to put that in a box and not have anything to say who you are. It’s not an easy thing to do.<sup>71</sup>

Mailing original documents results in lost documents and additional work for the IRS.<sup>72</sup> The IRS will only return documents by expedited mail if the taxpayer has provided a prepaid envelope or TAS makes a request based on significant hardship.<sup>73</sup> In 2015, the IRS returned 5,839 passports to embassies when it could not find a better address.<sup>74</sup> Compounding this problem is the PATH Act’s elimination of the ability for CAAs to review documents for applicants abroad.<sup>75</sup> The IRS has not authorized any designees at diplomatic or consular posts abroad to receive ITIN applications due to limited resources cited by the Department of State. However, until a recent meeting on December 2, 2016, which may have been prompted by TAS’s inquiries, the IRS had not met with the Department of State regarding this topic since May 2015, prior to the passage of the PATH Act.<sup>76</sup>

Finally, requiring original documents leads to a high rejection rate, with almost a third of applications rejected during the past three years.<sup>77</sup> In recent years, the number one reason for suspending ITIN applications was that documentation did not meet IRS criteria.<sup>78</sup> By requiring that original documents be mailed, the IRS is discouraging applicants from using documents like passports or birth certificates in favor of more informal documents like school records, which may not meet the IRS’s narrow requirements for those documents.<sup>79</sup>

70 The IRS had reported that Taxpayer Assistance Centers can offer ITIN services only on Tuesdays and Thursdays, but has since clarified “[w]hile Accounts Management assistants will continue to schedule the majority of ITIN service appointments on Tuesdays and Thursdays, we will closely monitor the traffic to determine if this service should be offered on additional days.” IRS, *Taxpayer Assistance Center (TAC) Locations Where In-Person Document Review is Provided*, <https://www.irs.gov/uac/tac-locations-where-in-person-document-verification-is-provided> (last updated Sept. 1, 2016); IRS response to TAS fact check (Dec. 20, 2016). See National Taxpayer Advocate FY 2017 Objectives Report to Congress 150-51.

71 Statement of German Tejeda, Senior Director, Income Policy Food Bank for New York City, Public Forum, Hostos Community College, Bronx, New York (Mar. 18, 2016).

72 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 152.

73 See Internal Revenue Manual (IRM) 3.21.263.4.10, *Taxpayer Advocate Service (TAS) Assistance* (Oct. 19, 2015), IRM 3.21.263.5.3.4.2.4, *Returning Original Supporting Identification Documents to Applicant* (Oct. 19, 2015).

74 The IRS does not track the number of lost original documents. IRS response to TAS information request (Nov. 29, 2016).

75 See Legislative Recommendation: *Certified Acceptance Agents (CAAs): Amend the PATH Act to Authorize CAAs to Certify Individual Taxpayer Identification Number Applications for Taxpayers Residing Abroad*, *infra*. See also Letter from Richard M. Reedman, President, Nat’l Ass’n of Enrolled Agents, to John A. Koskinen, Commissioner, Internal Revenue Service (Dec. 13, 2016) (on file with TAS) (expressing opposition to the IRS terminating the contracts of CAAs operating abroad).

76 IRS response to TAS fact check (Dec. 20, 2016). In response to TAS’s information request, the IRS stated it is working to set up another meeting with the Department of State to ask for assistance in some key countries due to the PATH Act’s elimination of CAAs abroad. IRS response to TAS information request (Nov. 29, 2016). Currently, there are 275 U.S. consulates and embassies that provide a similar service for Social Security number applicants. See email from Department of State governmental liaison to TAS (Sept. 9, 2015) (on file with TAS); email from Social Security Administration governmental liaison to TAS (Sept. 23, 2015) (on file with TAS).

77 IRS, *ITIN Comparative Reports* (Dec. 3, 2016, Dec. 30, 2015, and Dec. 31, 2014).

78 National Taxpayer Advocate 2015 Annual Report to Congress 208.

79 For example, a school record “must be dated and contain the student’s name, course work with grades (unless under age 6), date of grading period(s) (unless under age 6), and school name and address.” Instructions for Form W-7 (Sept. 2016).

### Math Error Procedures for Applicants Whose ITIN Applications Are Rejected or Whose ITINs Are Deactivated Infringe on Taxpayer Rights

After the IRS rejects an ITIN application, it forwards the paper tax return to be processed, stripping the return of the persons without SSNs or valid ITINs and denying associated exemptions and deductions.<sup>80</sup> The IRS uses its math error procedure to recalculate the tax. In 2015 and 2016 the IRS denied approximately 400,000 personal exemptions during return processing, due to a problem with the Taxpayer Identification Number (TIN), which includes both incorrect SSNs and incorrect ITINs.<sup>81</sup> Letters notifying taxpayers that the IRS has disallowed their personal exemptions for ITIN related reasons often lack a clear explanation of the reason for disallowance. Stating “We didn’t allow your personal exemption because your ... ITIN ... is missing” is confusing because of course the ITIN was missing on the return — the taxpayer was not allowed to apply for the ITIN prior to filing the return.<sup>82</sup> Instead of telling the taxpayer that the ITIN is “missing”, the IRS notice should acknowledge the ITIN application, explain that the IRS denied it, and clearly explain to the taxpayer the reason for the denial. This notice infringes upon the taxpayer’s *right to be informed*.

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The Protecting Americans from Tax Hikes (PATH) Act gives the IRS latitude to provide alternatives to accepting only original documents or copies certified by the issuing agency. ... Yet, the IRS has failed to exercise this discretion and has not identified additional types of certified copies.

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The PATH Act will lead to more math error notices because it provides the IRS with math error authority in situations where a taxpayer lists a deactivated ITIN on a return.<sup>83</sup> Taxpayers unaware that their ITINs have expired may not find out until they file a return with the deactivated ITIN and receive a math error notice. A taxpayer whose ITIN was deactivated in error and was denied credits to which he or she is entitled will lose the opportunity to challenge eligibility for the credits in the U.S. Tax Court if he or she does not respond timely to the math error notice. This procedure may deprive low income or overseas taxpayers, in particular, of fundamental due process protections and infringe on their *right to challenge the IRS’s position and be heard*.<sup>84</sup>

### Taxpayers May Not Receive the Child Tax Credit (CTC) or American Opportunity Tax Credit (AOTC) if They Do Not Know to File Timely or if Their Returns Are Mishandled or Lost

Although the IRS policy regarding when a renewed ITIN is considered to be issued is beneficial to taxpayers, there may still be taxpayers who miss out on the CTC or AOTC if they do not understand the need to file their returns timely. The IRS has not issued formal guidance clarifying that the ITIN resulting from a new ITIN application will be deemed issued on the date the return is received. It is not

80 See IRM 3.21.263.4.5(2), *Internal Revenue Service Number (IRSIN)* (Jan. 1, 2015).

81 IRS, Transmitter Control Code Electronic Output Network System Report 480-62-11 (Dec. 29, 2015 and Dec. 1, 2016). See Taxpayer Notice Codes (TPNC) 205 (primary taxpayer), 206 (spouse), and 605 (dependent), described in IRM 3.12.3-2 (Jan. 1, 2016). The notices relate to denied personal exemptions for failure to provide a valid ITIN or SSN. The IRS additionally denied deductions and credits for failure to obtain or provide any TIN. See, e.g. TPNCs 234 and 235.

82 The IRS is developing new explanatory paragraphs to address the denial of CTC and AOTC resulting from expired ITINs. Email from Office of Taxpayer Correspondence (Aug. 24, 2016). For a more detailed discussion of the National Taxpayer Advocate’s concerns about the poor quality of IRS Math Error notices, see National Taxpayer Advocate 2014 Annual Report to Congress 163-71 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*).

83 PATH Act § 203(e) (codified at IRC § 6213(g)(2)(O)).

84 See Legislative Recommendation: *International Due Dates: Amend Internal Revenue Code § 6213(b)(2)(A) to Provide Additional Time to Request Abatement of a Math or Clerical Error Assessment to Taxpayers Living Abroad Similar to the Timeframe Afforded to Taxpayers to Respond to a Notice of Deficiency, infra*.

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**Requiring most new Individual Taxpayer Identification Number (ITIN) applications during the filing season results in less flexibility for applicants, longer wait times for original documents to be returned and an ITIN issued, overburdened Taxpayer Assistance Centers, and a heavier, more concentrated workload for the IRS.**

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until page 4 of the Form W-7 instructions that taxpayers are warned that failure to timely file a tax return and Form W-7 “may” result in denial of CTC or AOTC.<sup>85</sup> Furthermore, the IRS’s main ITIN webpage says nothing about the need to file on time to receive the CTC or AOTC.<sup>86</sup> The IRS should conduct targeted outreach to communities with a high number of CTC claims to ensure taxpayers are aware of this requirement.

Even if they file on time, taxpayers may also be denied CTC or AOTC if their returns are lost or mishandled<sup>87</sup> and they cannot prove the IRS received the return or ITIN application prior to the due date.<sup>88</sup> Taxpayers may also face problems if the IRS incorrectly rejects their applications because they will have to reapply, and the IRS has stated “[a]n applicant error that results in a rejected Form W-7 application may impact the assignment/issuance date of the ITIN.”<sup>89</sup> It is unknown whether the IRS will use the date of the original ITIN application submitted with the return or the date of the second ITIN application.

**The General Requirement for New Applicants to Apply for an ITIN During the Filing Season Burdens Applicants, Creates Delays, Hampers Fraud Detection, and Exacerbates the Other Problems ITIN Applicants Face**

One of the most significant problems with the ITIN process has persisted for over a decade and exacerbates the other problems discussed above. In 2003, the IRS began requiring most ITIN applications to be filed with a paper tax return.<sup>90</sup> There are limited exceptions for nonresidents claiming the benefits of a tax treaty and having income, payments, or transactions subject to third-party reporting or withholding.<sup>91</sup> While the recent accommodation for renewal applicants to apply prior to the filing season is very positive, at least for the 2017 filing season the IRS will not be processing the renewal applications and issuing the ITINs until the actual filing season. Furthermore, the accommodation excludes the 800,000 first time applicants who apply annually, unless they are family members of the renewal applicants.<sup>92</sup> The paper driven process results in applicants waiting up to 14 weeks to receive

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85 Instructions for Form W-7 (Sept. 2016).

86 IRS, ITIN, <https://www.irs.gov/individuals/individual-taxpayer-identification-number-itin> (updated Oct. 12, 2016).

87 See National Taxpayer Advocate 2015 Annual Report to Congress, 202. The IRS does not track the number of complaints regarding lost returns. IRS response to TAS information request (Nov. 29, 2016).

88 Although the IRS has stated the ITIN will be considered to be issued on the date the ITIN application and associated return (if attached) are received, the IRS’s internal math error procedures appear to flag a CTC claim or AOTC claim based solely on the date the return is received. See IRM 3.11.3.14.5.5, Line 52 - Child Tax Credit (Schedule 8812) (Sept. 23, 2016); IRM 3.11.3.44.4, *Form 8863, Part III - Student and Educational Institution Information* (Sept. 14, 2016). These IRM references are based on the manual process to address tax year 2015 returns filed in 2016 with new ITIN assignments. Starting Jan. 1, 2017, the math error will be systemically checked. Beginning March 14, 2017, programming changes will be in place to compute the ITIN Assignment Date as the IRS Received Date. IRS response to TAS fact check (Dec. 20, 2016).

89 IRS response to TAS fact check (Dec. 20, 2016).

90 See National Taxpayer Advocate 2003 Annual Report to Congress 60-86 (Most Serious Problem: *Individual Taxpayer Identification Number (ITIN) Program and Application Process*).

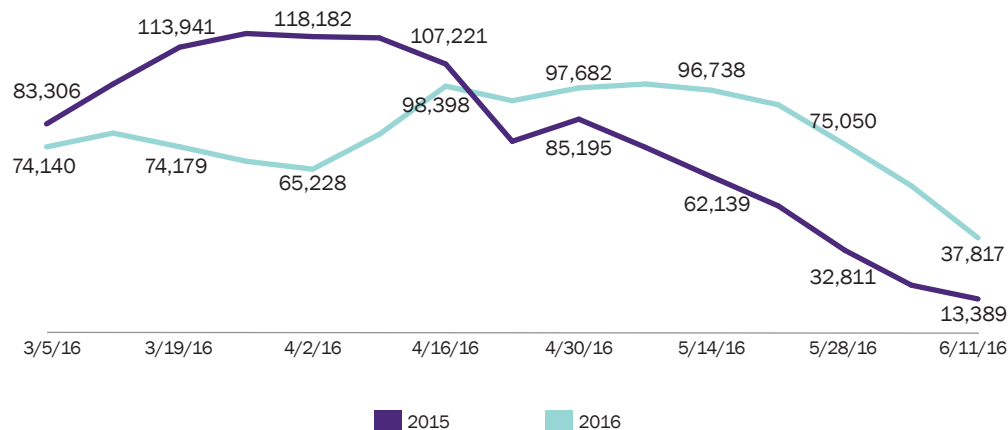
91 See Form W-7 instructions (Sep. 2016). In PY 2015, about 53,900 out of 874,800 ITIN applicants (six percent) claimed an exception for filing without a tax return. IRS, CDW, Form W-7 Database (data drawn Dec. 13, 2016).

92 IRS, *ITIN Production Report* (Dec. 3, 2016). Receipts for the first 11 months of PY 2016 totaled 795,765 applications with returns, 67,423 without returns, and prior year carryover of 31,695.

their tax refunds, compared to the three weeks for taxpayers with SSNs.<sup>93</sup> The following chart reflects the increase in the average weekly backlog over the prior year.

**FIGURE 1.18.4**

**Weekly Backlogs of Applications With Returns Awaiting Input**



Requiring most new ITIN applications during the filing season results in less flexibility for applicants, longer wait times for original documents to be returned and an ITIN issued, overburdened TACs, and a heavier, more concentrated workload for the IRS. It also prevents applicants from electronically filing their returns, which increases the potential for identity theft, increases the risk of returns being lost or misprocessed, and undermines taxpayers' *right to a fair and just tax system*.<sup>94</sup> Accepting ITIN applications year round would allow the IRS to identify trends throughout the year and later apply rules to detect fraudulent returns through the enhanced Return Review Program (RRP). It may also help the IRS avoid labor intensive and taxpayer-burdensome compliance initiatives during the filing season that unnecessarily delay refunds.<sup>95</sup>

The National Taxpayer Advocate has previously suggested alternatives to submitting a tax return to prove a tax administration purpose for an ITIN, such as submitting pay stubs or bank statements.<sup>96</sup> Not only does the IRS accept these to prove income belonged to a person in the case of a Form W-7 and Form W-2 name mismatch,<sup>97</sup> but the IRS now accepts bank statements to prove residency for the purpose of issuing

93 See *2016 Tax Season Refund Frequently Asked Questions*, <http://www.irs.gov/Refunds/Tax-Season-Refund-Frequently-Asked-Questions> (last updated July 29, 2016).

94 See IRS Publication 4852, *Talkpoints for Managers* (Jan. 2016) (advising federal employees to e-file their tax returns to increase accuracy and avoid mistakes such as math errors and omissions).

95 The IRS's Form 1042S verification project delayed legitimate tax refunds for foreign students due in part to untimely assignment of ITINs. See National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84 (Area of Focus: *IRS Implementation and Enforcement of Withholding on Certain Payments to Foreign Persons Is Burdensome, Error-Ridden, and Fails to Protect the Rights of Affected Taxpayers*); see also, Most Serious Problem: *Foreign Account Tax Compliance Act (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *supra*. See also Systemic Advocacy Management System (SAMS) 34152.

96 See National Taxpayer Advocate 2015 Annual Report to Congress 212.

97 Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Sept. 2016); Form W-2, *Wage and Tax Statement* (2016). A name mismatch occurs when the taxpayer's name on the Form W-7 is different from the taxpayer's name on Form W-2. See IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Aug. 18, 2014).



the ITIN.<sup>98</sup> The IRS should “re-evaluate evidence of filing requirements,” as promised in its response to last year’s Annual Report to Congress.<sup>99</sup>

## CONCLUSION

The IRS has made some major changes to the ITIN program in response to the PATH Act, but falls short in terms of making it possible for all taxpayers to timely comply with their filing and payment obligations. The National Taxpayer Advocate remains concerned that the IRS has not included TAS in ITIN cross-functional teams nor has it sought TAS’s input regarding the sweeping changes, which fail to protect key taxpayer rights, such as the *right to be informed*, the *right to challenge the IRS’s position and be heard*, and the *right to a fair and just tax system*.<sup>100</sup> While the PATH Act presents significant challenges for the IRS, it also offers the IRS latitude to make much needed changes. Nothing in the legislation prevents the IRS from accepting ITIN applications for all applicants year-round with proof of a tax administration purpose. ITIN applicants will continue to face barriers to filing and paying their taxes until the IRS further revises its ITIN policies and procedures.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Prioritize and accelerate the programming and implementation of the necessary systems to process ITIN renewal applications and reissue ITINs upon receipt of renewal applications.
2. Identify additional types of documentation that can be considered “certified copies,” such as copies certified by state or other Federal agencies other than the issuing agency, copies certified by clerks of courts, copies properly apostilled and authenticated by U.S. diplomatic missions abroad, and notarized copies from specific jurisdictions.
3. Allow all ITIN applicants to apply for an ITIN at any time of the year without a tax return as long as they provide evidence of a legitimate tax administration purpose for the ITIN.

98 IRS Works to Help Taxpayers Affected by ITIN Changes; Renewals Begin in October, IR-2016-100 (Aug. 4, 2016).

99 See National Taxpayer Advocate FY 2017 Objectives Report to Congress vol. 2, 116.

100 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 148-49.

**MSP  
#19****FORM 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations****RESPONSIBLE OFFICIAL**

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Finality*

**DEFINITION OF PROBLEM**

In 2014, the IRS adopted Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, which requires applicants to merely attest, by checking boxes on the form, that they meet the requirements for qualification as IRC § 501(c)(3) organizations.<sup>2</sup> Most applications for IRC § 501(c)(3) status are now submitted on Form 1023-EZ and the IRS approves 94 percent of Form 1023-EZ applications.<sup>3</sup>

The IRS erroneously approves Form 1023-EZ applications at an unacceptably high rate:

- According to the IRS's pre-determination reviews of a portion of Form 1023-EZ applicants, 25 percent do not qualify for exempt status because they do not meet the "organizational test;"<sup>4</sup>
- According to a 2015 TAS study of a representative sample of approved Form 1023-EZ applicants in 20 states that make articles of incorporation viewable online at no cost, 37 percent do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law;<sup>5</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Among other things, organizations eligible to submit Form 1023-EZ must generally have annual gross receipts of less than \$50,000 and assets of less than \$250,000. See *Form 1023-EZ Eligibility Worksheet*, questions 1-3.

3 Tax Exempt and Government Entities (TE/GE) Fiscal Year (FY) 2016 Third Qtr. Business Performance Review (BPR), at 5 (Sept. 2016) (noting that 58 percent of all applications for IRC § 501(c)(3) status were submitted on Form 1023-EZ).

4 TE/GE response to TAS information request (Oct. 5, 2016). As described below, the "organizational test" generally requires an applicant's organizing document to contain adequate purpose and dissolution clauses. See Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4); 1.501(c)(3)-1(b)(2).

5 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*). As described below, the "organizational test" generally requires an applicant's organizing document to contain adequate purpose and dissolution clauses. See Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4); 1.501(c)(3)-1(b)(2).

- According to the IRS's analysis, at least 17 percent of the Form 1023-EZ applicants in the sample TAS analyzed in its 2015 study do not meet the organizational test;<sup>6</sup> and
- According to a 2016 TAS study using similar methodology as the 2015 TAS study, 26 percent of approved Form 1023-EZ applicants do not meet the organizational test.

On October 25, 2016, the IRS Deputy Commissioner for Services and Enforcement sustained the National Taxpayer Advocate's September 26, 2016 Taxpayer Advocate Directive (TAD) which directs the Tax Exempt and Government Entities division (TE/GE) to require Form 1023-EZ applicants to submit a brief narrative statement of their actual or planned activities.<sup>7</sup> The Deputy Commissioner rescinded the portion of the TAD that directs TE/GE to require Form 1023-EZ applicants to submit summary financial information and organizing documents not already available from a State online database.<sup>8</sup>

## ANALYSIS OF PROBLEM

### Background

An applicant seeking to qualify as an organization described in IRC § 501(c)(3) must demonstrate that it meets an “organizational test” and an “operational test.”<sup>9</sup> The “organizational test” requires an applicant’s “organizing document” to establish that it is “organized and operated exclusively” for one of eight enumerated exempt purposes.<sup>10</sup> The “operational test” requires the applicant to engage primarily in activities which accomplish one or more of the eight exempt purposes specified in IRC § 501(c)(3).<sup>11</sup> No more than an insubstantial part of its activities can be not in furtherance of an exempt purpose,<sup>12</sup> and the organization must be operated to further public rather than private interests.<sup>13</sup>

In 2014, TE/GE adopted “streamlined” procedures that allowed some organizations whose Form 1023 applications needed further development to provide “assurance of meeting the organizational and operational tests through representational attestations” (as opposed to submitting substantiating

6 TE/GE response to National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016). TAD 2016-1 is attached as an appendix to this Most Serious Problem.

7 Memorandum from the Deputy Commissioner for Services and Enforcement to the National Taxpayer Advocate (Oct. 25, 2016).

8 *Id.*

9 Treas. Reg. § 1.501(c)(3)-1(a)(1) (providing that “[i]f an organization fails to meet either the organizational test or the operational test, it is not exempt.”).

10 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (providing “[a]n organization is organized exclusively for one or more exempt purposes only if its articles of organization,” among other things, limit the purposes of such organization to one or more exempt purposes); Treas. Reg. § 1.501(c)(3)-1(b)(4) (providing “[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization’s assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization’s articles or by operation of law, be distributed for one or more exempt purposes...”). In some states, sometimes referred to as *cy pres* states, a dissolution clause is not required because by operation of state law, the organization’s assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. See Rev. Proc. 82-2, 1982-1 C.B. 367.

11 See Treas. Reg. § 1.501(c)(3)-1(c)(1) (providing that “[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)”).

12 See Treas. Reg. § 1.501(c)(3)-1(c)(1) (providing that “[a]n organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose”).

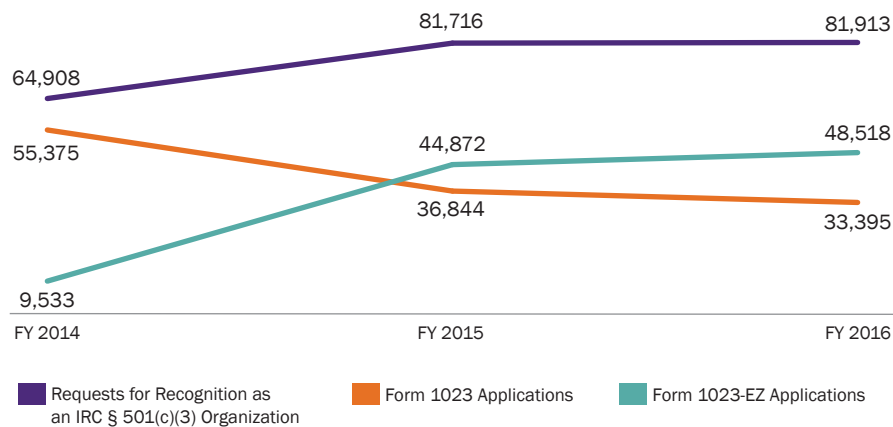
13 Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

documents).<sup>14</sup> In July 2014, TE/GE introduced Form 1023-EZ, which incorporates the “attestation” feature of the streamlined procedures.

Applications for exempt status under IRC § 501(c)(3) immediately increased following introduction of the streamlined procedures and Form 1023-EZ. Figure 1.19.1 shows the total number of applications for IRC § 501(c)(3) status, the number submitted on Form 1023, and the number submitted on Form 1023-EZ.

**FIGURE 1.19.1**<sup>15</sup>

**Requests for Recognition as an IRC § 501(c)(3) Organization, FYs 2014-2016**



As Figure 1.19.1 demonstrates, Form 1023-EZ fueled an increase in overall applications for IRC § 501(c)(3) status and has overtaken Form 1023 as the primary vehicle for requesting such status.

**Many Form 1023-EZ Applicants Are Recognized As IRC § 501(c)(3) Organizations Even Though They Do Not Qualify for That Status**

TE/GE subjects a sample of Form 1023-EZ filers to pre-determination review, rather than relying solely on their attestations. The 2,405 pre-determination reviews TE/GE had completed as of August 19, 2016, showed that Form 1023-EZ applicants did not meet the organizational test 25 percent of the time, despite their attestations to the contrary.<sup>16</sup> Yet TE/GE approves Form 1023-EZ applications 94 percent of the time.<sup>17</sup>

A 2015 TAS study of a representative sample of 408 corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ was approved found that 149 of the

<sup>14</sup> See TE/GE-07-0214-02, *Streamlined Processing Guidelines for All Cases* (Feb. 28, 2014).

<sup>15</sup> TE/GE response to TAS fact check (Nov. 28, 2016); TE/GE FY 2016 BPR First Qtr. Business Performance Review (BPR) at 4, 18 (Mar. 2016); TE/GE response to TAS information request (Nov. 14, 2016).

<sup>16</sup> TE/GE response to TAS information request (Oct. 5, 2016).

<sup>17</sup> TE/GE FY 2016 Third Qtr. BPR at 5 (Sept. 2016).

The 2016 TAS study showed that of 323 organizations in the representative sample, 85 organizations, or 26 percent, do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law.

organizations in the sample (37 percent) did not satisfy the organizational test.<sup>18</sup> Prior to the release of the report, TAS shared with TE/GE the Employee Identification Numbers (EINs) of all 149 of these organizations and TE/GE advised TAS it did not agree with all of TAS's conclusions.<sup>19</sup> However, TE/GE refused to provide a list of organizations whose organizing documents, according to its analysis, were sufficient.<sup>20</sup> The National Taxpayer Advocate's September 26, 2016, Taxpayer Advocate Directive directed the IRS to share its list with TAS, and TE/GE complied with that directive on October 5, 2016.<sup>21</sup>

According to TE/GE's analysis of the 149 organizations, documents for 13 were no longer available online, and one organization was selected for pre-determination review.<sup>22</sup> Of the remaining organizations, TE/GE concluded that "only" 70 had failed to meet the organizational test.<sup>23</sup> Thus, according to TE/GE's analysis (and assuming that all 14 organizations TE/GE did not review met the organizational test), there is an "organizational test non-compliance rate" of 17 percent.<sup>24</sup>

In 2016, TAS conducted a research study using methodology similar to that used for the 2015, study. TE/GE provided TAS Research a data file with the names, EINs, state of incorporation, ruling date, and addresses of all corporations whose Form 1023-EZ applications were approved from July 1, 2015, through June 30, 2016.<sup>25</sup> From the data file, TAS Research identified a representative random sample of 323 organizations from the 20 states that make articles of incorporation viewable online at no cost.<sup>26</sup> TAS evaluated the organizations in the sample using the same data collection instrument that was used for the 2015 TAS study. The results of the study are statistically valid at the 95 percent confidence level with a margin of error no greater than +/-5 percent.<sup>27</sup> The 2016 TAS study showed that of 323 organizations

18 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 13 (*Study of Taxpayers that Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*).

19 TE/GE response to TAS information request (July 12, 2016).

20 Email from Director, Exempt Organizations – Rulings & Agreements (Aug. 4, 2016), on file with TAS.

21 TE/GE response to National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016).

22 As of Oct. 11, 2016, TAS found all 13 organizations' documents online for their respective states. TE/GE's list notes, with respect to one organization "Selected for pre-determination review. Signed attestation stating they amended." As of Nov. 2, 2016, we were unable to find any record of any amendment to that organization's articles of incorporation.

23 TE/GE response to National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016).

24 TE/GE response to TAS fact check (Nov. 28, 2016). Out of a sample size of 408 approved organizations, a finding that 70 did not meet the organizational test represents an error rate of 17 percent. To the extent the organizations TE/GE did not review also did not meet the organizational test, the error rate would be greater. Moreover, TAS does not entirely accept TE/GE's analysis. TAS would concede that the organizing documents of 13 of the 149 corporations could reasonably be construed as meeting the organizational test, but adheres to its conclusion that the other 136 organizations did not meet the organizational test. Out of a sample of 408, a finding that 136 organizations did not meet the organizational test represents an erroneous approval rate of 33 percent.

25 TE/GE response to TAS information request (Sept. 23, 2016). There were 38,196 separate organizations in this file. Of these organizations, 16,295, or approximately 43 percent, were incorporated in the 20 states in which the Secretary of State maintains a website that permitted TAS to view legible copies of corporations' articles of incorporation at no charge.

26 TAS initially identified 330 organizations for further analysis, but articles of incorporation for seven organizations could not be located on the official site for the state in which, according to TE/GE, the organization was formed. These organizations were thus excluded, resulting in a sample size of 323.

27 Study findings can be projected to the population of 16,295 organizations from states in our study.

in the representative sample, 85 organizations, or 26 percent, do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law. Moreover, in the representative sample of 323 organizations, the articles of incorporation of 12, or four percent, showed that two were limited liability companies, two were churches, seven were schools, colleges or universities or supporting organizations, and one was a private operating foundation. These organizations are never eligible to file Form 1023-EZ, yet they possess a determination letter from the IRS and are holding themselves out as tax exempt.<sup>28</sup>

### Post-Determination Audits Are Inadequate Substitutes for Pre-Determination Oversight

TE/GE estimates that it takes an average of 17 hours to conduct a post-determination audit of an organization that filed Form 1023-EZ.<sup>29</sup> It takes an average of five hours to conduct a pre-determination review of a Form 1023-EZ application.<sup>30</sup> Thus, TE/GE could carry out roughly three pre-determination reviews for every post-determination audit. Because pre-determination reviews are generally carried out by higher-graded employees than those who perform audits, audits do not necessarily cost three times more than pre-determination reviews. Moreover, pre-determination reviews could avert the expenses of administrative appeals and litigation stemming from a post-determination audit that culminates in a proposed revocation of exempt status.<sup>31</sup> In any event, by identifying an organization's non-qualification earlier in the process, while the IRS still has leverage and the stakes for the organization are lower, an organization may self-correct, thus averting noncompliance. The cost of noncompliance includes unreported taxable income and claimed deductions for charitable contributions that are later determined to be impermissible.<sup>32</sup> Additional compliance costs include the erosion of taxpayer trust, consumer abuse, and the heightened potential for fraud.

### Form 1023-EZ Burdens Potential Donors and State Charity Officials, Who Can No Longer Rely on the IRS's Determinations

Some state charity officials warn potential donors that organizations whose exempt status was obtained by filing Form 1023-EZ require more thorough review to assess whether they are indeed IRC § 501(c)(3) organizations, and some institutional grantors simply treat those organizations as ineligible to receive

28 See *Form 1023-EZ Eligibility Worksheet*, questions 7, 10, 11, 21, and 25. Organizations that do not meet the Form 1023-EZ eligibility requirements may qualify as IRC § 501(c)(3) organizations, but they must apply for recognition using a full Form 1023.

29 TE/GE response to TAS information request (July 12, 2016). These correspondence examinations are conducted primarily by Tax Compliance Officers in the EO Compliance Area. It appears that employees who conduct these audits would normally be graded as GS-9 or lower. See Internal Revenue Manual 4.75.27.1, *Overview* (June 1, 2010).

30 *Id.* As TE/GE notes, “[t]hese determinations are conducted by Revenue Agents in EO Determinations that are generally Grade 11 or 12 employees. This estimate only includes time directly attributable to the case by the Revenue Agent. It does not include other processing time, such as time required by clerical staff to establish the case, assign the case to the group, close the case from the system, issue final letters, backend scan paper documents into the system, manage paper files, etc. It also does not include managerial time to assign the case to the agent, review letters, and review cases for closure; nor does it include potential time charged by Quality Assurance personnel for quality review.”

31 See Rev. Proc. 2016-5, § 12, 2016-1 I.R.B. 188 (providing for revocation (which may be retroactive) or modification of a determination letter recognizing exemption, and affording the same procedures for appealing such revocation or modification as those applicable to denials of an initial application for exempt status); IRC § 7428 (providing for review by the Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia of the IRS's determination with respect to the initial or continuing qualification or classification of an organization under IRC § 501(c)(3)).

32 Organizations exempt from tax under IRC § 501(c)(3) are generally not required to pay tax on their related income and may receive tax deductible contributions. See IRC §§ 501 and 170(c)(2). An organization determined to not have been tax exempt would be treated as a taxable entity required to report and pay tax on income (whether related to the erstwhile exempt purpose or not).



grants.<sup>33</sup> At least one state plans to collect data about how often an IRS determination letter granting IRC § 501(c)(3) status on the basis of a Form 1023-EZ application is insufficient for state registration purposes.<sup>34</sup> Anecdotal evidences suggests the frequency may be as high as 25 percent of the time in that state.<sup>35</sup>

## CONCLUSION

Experience with Form 1023-EZ shows that a significant portion of approved Form 1023-EZ applicants do not qualify for IRC § 501(c)(3) status as a matter of law. In spite of this evidence, TE/GE has continued to rely on Form 1023-EZ and has chosen to substitute time-consuming audits for pre-determination oversight. Moreover, by relinquishing its upfront leverage for achieving compliance via the determination letter process, the IRS has simply shifted the burden of consumer protection and verification downstream to states and donors. This has opened up a gap in which taxpayers and consumers are harmed.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that:

1. In addition to revising Form 1023-EZ to require applicants to provide a brief narrative statement of their actual or planned activities, as directed by the National Taxpayer Advocate's sustained TAD, revise Form 1023-EZ to:
  - a. Require applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to submit their organizing documents; and
  - b. Require applicants to submit summary financial information such as past and projected revenues and expenses.
2. Make a determination about qualification as an IRC § 501(c)(3) organization only after reviewing an applicant's narrative statement of actual or planned activities, organizing documents, and summary financial information.
3. Where there is a deficiency in an organizing document, require an applicant to submit a copy of an amendment to its organizing document that corrects the deficiency and has been approved by the state, even where the documents are available online at no cost, before conferring exempt status.

33 Notes of TAS interview of the President of the National Association of State Charities Officials (NASCO) (Aug. 25, 2015), on file with TAS.

34 Notes of TAS interview of Assistant Director, Charitable Trusts Unit, New Hampshire Dept. of Attorney General (Aug. 10, 2016), on file with TAS.

35 *Id.*

## APPENDIX 1, TAXPAYER ADVOCATE DIRECTIVE FROM NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE

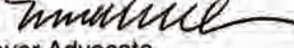


THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE

September 26, 2016

**Response Due: December 28, 2016**  
**Completed By: December 28, 2016**

MEMORANDUM FOR SUNITA LOUGH, COMMISSIONER,  
TAX EXEMPT AND GOVERNMENT ENTITIES

FROM: Nina E. Olson   
National Taxpayer Advocate

SUBJECT: Taxpayer Advocate Directive **2016-1**, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS*

### TAXPAYER ADVOCATE DIRECTIVE

Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a Taxpayer Advocate Directive (TAD). A TAD may be issued to (1) mandate administrative or procedural changes to improve the operation of a functional process, or (2) grant relief to groups of taxpayers (or all taxpayers) when its implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.<sup>1</sup>

<sup>1</sup> Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a TAD "to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers." Internal Revenue Manual (IRM) 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).



## 2

Internal Revenue Manual (IRM) 13.2.1.6.1 (July 16, 2009) provides that in advance of issuing a TAD, the National Taxpayer Advocate attempts to work with and communicate with the owners of the process in order to correct the problem. I included the issue of erroneous approvals of Form 1023-EZ applications as a Most Serious Problem in my most recent Annual Report to Congress, and supported my concerns with the findings of a TAS research study.<sup>2</sup> As described in my Fiscal Year 2017 Annual Report to Congress, I attempted to resolve this issue, and TE/GE rejected my recommendation that it take corrective measures.<sup>3</sup> I noted that I would continue to advocate for taxpayers by issuing this TAD.<sup>4</sup> TE/GE's responses to my recommendations, included in Volume 2 of my Fiscal Year 2017 Annual Report to Congress, show the IRS's continuing refusal to take corrective measures.<sup>5</sup> These reports serve as a formal memorandum issued to the responsible operating area within the meaning of IRM 13.2.1.6.1.2 (July 16, 2009). Therefore, all procedural requirements for issuing this TAD have been satisfied.<sup>6</sup>

I now direct you to take the following actions with respect to Form 1023-EZ:

1. Revise Form 1023-EZ to require applicants to submit:
  - a. A brief narrative statement of their actual or planned activities;
  - b. Summary financial information such as past and projected revenues and expenses; and
  - c. Their organizing documents (unless the documents are already retrievable from a State online database); and
2. Change your procedures to require review of these materials prior to making a determination.

Prior to the release of my 2016 Annual Report to Congress, TAS shared with you the EINs of 149 organizations whose articles of incorporation were insufficient for

<sup>2</sup> National Taxpayer Advocate 2015 Annual Report to Congress 36-44 (Most Serious Problem: Form 1023-EZ: Recognition as a Tax-Exempt Organization is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to be Taxable); vol. 2, 1-32 (Research Study: Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ), attached.

<sup>3</sup> National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 181-183 (Area of Focus: *The IRS Is Aware That a Significant Proportion of Form 1023-EZ Applications It Approves Are Submitted by Organizations That Do Not Meet the Legal Requirements for IRC § 501(c)(3) Status, But It Has Not Acted to Correct Known Errors and Has Not Revised the Form to Prevent These Erroneous Approvals*), attached.

<sup>4</sup> National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 183 (Area of Focus: *The IRS Is Aware That a Significant Proportion of Form 1023-EZ Applications It Approves Are Submitted by Organizations That Do Not Meet the Legal Requirements for IRC § 501(c)(3) Status, But It Has Not Acted to Correct Known Errors and Has Not Revised the Form to Prevent These Erroneous Approvals*), attached.

<sup>5</sup> TE/GE response to the National Taxpayer Advocate 2015 Annual Report to Congress, reported in National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress vol. 2, 11-16 (Aug. 24, 2016).

<sup>6</sup> IRM 13.2.1.6.2(1), *TAD Appeal Process* (July 16, 2009).



## 3

qualification as an IRC § 501(c)(3) organization. You indicated that you did not agree with TAS's conclusions in all cases. Therefore, in addition to the above actions, I also direct you to:

3. Provide TAS the Employer Identification Numbers (EINS) for the entities whose organizing documents you agree are insufficient for qualification as an IRC § 501(c)(3) organization; and
4. Provide TAS the EINs for the entities whose organizing documents you believe are sufficient for qualification as an IRC § 501(c)(3) organization and explain your conclusion with respect to each of these entities.

Please provide a written response to this TAD on or before **December 28, 2016**, or elevate this TAD to the Commissioner of Internal Revenue within ten (10) calendar days of the date on this TAD. If you are complying with this TAD, the actions above must be completed no later than **December 28, 2016**.

## I. Issues

The IRS adopted Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* in July of 2014. Because the form does not elicit enough information from applicants to allow the IRS to make a determination as to whether the organization qualifies under IRC § 501(c)(3) as an organization exempt from taxation under IRC § 501(a), TE/GE erroneously grants exempt status at an unacceptably high rate.

## II. Procedural History

I have voiced concerns about the adoption of Form 1023-EZ since it was proposed in 2014.<sup>7</sup> My concern was that the IRS, by adopting the form, would essentially abdicate its responsibility to make determinations as to whether an organization meets the qualifications under IRC § 501(c)(3) for tax-exempt status. Subsequent events showed my concern was justified.

According to the applicable statutory framework, an applicant seeking to qualify as an organization described in IRC § 501(c)(3) must demonstrate that it meets an "organizational test" and an "operational test."<sup>8</sup> The "organizational test" requires an applicant's organizing document to establish that it is "organized and operated exclusively" for one of eight enumerated exempt purposes.<sup>9</sup> The

<sup>7</sup> See National Taxpayer Advocate Fiscal Year (FY) 2015 Objectives Report to Congress 54-7.

<sup>8</sup> Treas. Reg. § 1.501(c)(3)-1(a)(1) (providing that "[i]f an organization fails to meet either the organizational test or the operational test, it is not exempt.>").

<sup>9</sup> IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (providing "[a]n organization is organized exclusively for one or more exempt purposes only if its articles of organization," among other things, limit the purposes of such organization to one or more exempt purposes); Treas. Reg. § 1.501(c)(3)-1(b)(4) (providing "[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such



"operational test" requires the applicant to engage primarily in activities which accomplish one or more of the eight exempt purposes specified in IRC § 501(c)(3).<sup>10</sup> No more than an insubstantial part of its activities can be not in furtherance of an exempt purpose,<sup>11</sup> and the organization must be operated to further public rather than private interests.<sup>12</sup>

TE/GE has known since it introduced Form 1023-EZ that its reliance on the form led it to approve applications by organizations that did not meet the legal requirements to be considered an IRC § 501(c)(3) organization. This is because Form 1023-EZ applications that do not receive pre-determination review are approved 95 percent of the time, but applications that are subject to slightly more scrutiny are approved only 77 percent of the time. When an application is rejected after being subjected to pre-determination review, it is often because the organization does not or cannot respond to basic inquiries from the IRS about its activities.

TAS provided TE/GE with further evidence of the unreliability of Form 1023-EZ. In 2015, TAS analyzed the organizing documents of a representative sample of corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ was approved. The study concluded that 149 out of 408 organizations, or 37 percent, did not satisfy the organizational test and therefore were not, as a matter of law, IRC § 501(c)(3) organizations.

TAS shared the EINs of the 149 organizations with the Exempt Organizations (EO) function of TE/GE and requested that EO assist these organizations by reviewing their organizing documents and requiring them to correct any deficiencies. EO informed TAS it does not agree that all 149 applications were erroneously approved, but refused to explain its conclusions about specific organizations' applications with TAS. EO refused to contact even those organizations it acknowledges do not meet the organizational test, a legal requirement for qualifying as an IRC § 501(c)(3) organization, and whose applications were indeed approved in error. Instead, EO referred all 149 organizations to EO Examination, which may or may not result in audits.<sup>13</sup>

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assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes..." ). In some states, sometimes referred to as *cy pres* states, a dissolution clause is not required because by operation of state law, the organization's assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. See Rev. Proc. 82-2, 1982-1 C.B. 367.

<sup>10</sup> See Treas. Reg. § 1.501(c)(3)-1(c)(1), providing that "[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)."

<sup>11</sup> See Treas. Reg. § 1.501(c)(3)-1(c)(1), providing that "[a]n organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose."

<sup>12</sup> Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

<sup>13</sup> As EO informed TAS, "we did our own review of the 149 organizations and agreed that 59 of those failed the purpose test requirement but only 15 failed the dissolution requirements (note: some of those 15 may have also failed the purpose test); however, just that circumstance alone



TAS also recommended that TE/GE revise Form 1023-EZ to avert future erroneous approvals. The IRS has refused to adjust Form 1023-EZ to solicit information from applicants that would allow it to truly make a determination as to whether they qualify for status as an IRC § 501(c)(3) organization.

### III. Analysis

In view of EO's indifference to the TAS research study findings, it appears that EO has effectively written the organizational test out of existence. By improperly granting an organization IRC § 501(c)(3) status when it does not meet the legal requirements, the IRS burdens all taxpayers. Approved organizations do not report and pay tax on income that should be subject to tax, and donors claim deductions for contributions that should not be deductible.

The cursory review afforded by Form 1023-EZ invites noncompliance and manipulation. Here is an example of the relevant portion of the articles of incorporation of one corporation whose Form 1023-EZ was approved:

My father [named individual], suffered [sic] a spinal cord injury in February 2013, which left him a quadriplegic [sic]. His physicians and physical therapists say he is capable of recovering and walking again but his insurance ([name of State] Medicaid) will not cover the expense, so we are hosting fundraisers/benefits to try to raise the money on our own to pay for his therapy out of pocket.<sup>14</sup>

This organization's articles of incorporation, which do not identify any exempt purpose, do not meet the organizational test. Moreover, the articles appear to prevent the organization from operating to further public rather than private interests - they effectively prevent it from meeting the *operational* test. A simple review of this corporation's articles of incorporation would presumably have led the IRS to question whether the organization truly qualifies for tax-exempt status under IRC § 501(c)(3). Instead, by exempting this organization from paying taxes and allowing deductible contributions to it, the IRS failed to apply the law and failed to protect the interests of all taxpayers.

Form 1023-EZ applicants are also harmed because they are deprived of an essential service - effective review of their request for tax-exempt status under

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wouldn't likely necessitate subsequent revocation by Exam. In addition, we explained our risk mitigation efforts via the pre- and post-determination process (PDC) of the EZ to identify on-going compliance issues with the form. The listing of 149 organizations was turned over to EO Examination as a TAS referral. The organizations will be considered for audit under the established examination referral procedures." Email from Director, EO – Rulings & Agreements Executive Lead (Aug. 4, 2016), on file with TAS.

<sup>14</sup> This is the entire text that appears as the "purposes/nature of the business" in the articles of incorporation of an organization included in the TAS study described above. As of July 14, 2016, this corporation was still listed on the IRS's publicly accessible Select Check database as one to which tax deductible contributions may be made.



IRC § 501(c)(3). Defects in organizations' procedures or practices that come to light in a subsequent audit may trigger revocation of tax-exempt status (which may be retroactive). This outcome could be avoided by advising an applicant from the outset when a proposed organizational structure does not meet the organizational test and may even prevent the organization from meeting the organizational test.

Moreover, the IRS has simply shifted the burden of consumer protection and verification downstream to states and donors. Some state charity officials now warn potential donors that organizations whose exempt status was obtained on the basis of Form 1023-EZ require more thorough review to ascertain whether they are indeed IRC § 501(c)(3) organizations, and some institutional grantors simply treat those organizations as ineligible to receive grants.<sup>15</sup>

The harm caused by lack of meaningful review is far from abstract. Most applications for tax-exempt status under IRC § 501(c)(3) are now made using Form 1023-EZ, and as noted above, the IRS approves 95 percent of Form 1023-EZ applications.

#### IV. Requested Actions

Because the IRS has refused to revise Form 1023-EZ or to assist taxpayers whose Form 1023-EZ was erroneously approved, I am issuing this TAD to protect the rights of taxpayers and prevent undue burden. In light of the significant harm taxpayers are suffering as a result of the IRS's failure to act, I direct you to take the following actions:

I now direct you to take the following actions with respect to Form 1023-EZ:

1. Revise Form 1023-EZ to require applicants to submit:
  - a. A brief narrative statement of their actual or planned activities;
  - b. Summary financial information such as past and projected revenues and expenses; and
  - c. Their organizing documents (unless the documents are already retrievable from a State online database); and
2. Change your procedures to require review of these materials prior to making a determination.

In addition, with respect to the 149 organizations whose EINs TAS shared with you, I direct you to:

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<sup>15</sup> Notes of TAS interview of the President of the National Association of State Charities Officials (NASCO) (Aug. 25, 2015) on file with TAS.

## 7

3. Provide TAS the EINS for the entities whose organizing documents you agree are insufficient for qualification as an IRC § 501(c)(3) organization; and
4. Provide TAS the EINS for the entities whose organizing documents you believe are sufficient for qualification as an IRC § 501(c)(3) organization and explain your conclusion with respect to each of these entities.

Please provide a written response to this TAD on or before **December 28, 2016**, or elevate this TAD to the Commissioner of Internal Revenue within ten (10) calendar days of the date on this TAD. If you are complying with this TAD, the actions above must be completed no later than **December 28, 2016**. Please send any response or questions to me, with a copy to TAS Attorney Advisor Jill MacNabb.

## Attachments

- (1) National Taxpayer Advocate 2015 Annual Report to Congress 36-44  
(Most Serious Problem: *Form 1023-EZ: Recognition as a Tax-Exempt Organization is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to be Taxable.*)
  - (2) National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-32 (Research Study: *Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ.*)
  - (3) National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 181-183 (Area of Focus: *The IRS Is Aware That a Significant Proportion of Form 1023-EZ Applications It Approves Are Submitted by Organizations That Do Not Meet the Legal Requirements for IRC § 501(c)(3) Status, But It Has Not Acted to Correct Known Errors and Has Not Revised the Form to Prevent These Erroneous Approvals.*)
  - (4) TE/GE response to the National Taxpayer Advocate 2015 Annual Report to Congress, reported in National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress vol. 2, 11-16 (Aug. 24, 2016).
- cc: John A. Koskinen, Commissioner of Internal Revenue  
John M. Dalrymple, Deputy Commissioner, Services and Enforcement

MSP  
#20**AFFORDABLE CARE ACT (ACA): The IRS Has Made Progress in Implementing the Individual and Employer Provisions of the ACA But Challenges Remain****RESPONSIBLE OFFICIALS**

Carolyn A. Tavenner, Director, Affordable Care Act Office  
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division  
 Debra Holland, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*

**DEFINITION OF PROBLEM**

The IRS is charged with implementing certain provisions of the Patient Protection and Affordable Care Act of 2009 (ACA).<sup>2</sup> In addition to the existing provisions impacting individuals, some provisions of the ACA impacting employers became effective in tax year (TY) 2015.

In order to ensure that taxpayer rights are protected, TAS has been actively involved with the implementation of the ACA provisions. Some of the issues we reviewed include:

- In 2016, the IRS performed a systemic Individual Shared Responsibility Payment (ISRP) “recovery” to abate certain clearly identifiable ISRP overpayments;
- Premium Tax Credit (PTC) cases rose to become the fourth highest category of TAS case receipts during fiscal year (FY) 2016;<sup>3</sup>
- Advance Premium Tax Credit (APTC) recipients who incorrectly filed Form 1040-EZ, *Income Tax Return for Single and Joint Filers With No Dependent*, experienced delays in processing their returns;
- The IRS has developed procedures to address “silent returns” (*i.e.*, returns that do not have the minimum essential coverage (MEC) checkbox marked; Form 8965, *Health Coverage Exemptions*; or an amount for the ISRP);

<sup>1</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

<sup>2</sup> Patient Protection and Affordable Care Act of 2009 (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act (HCERA) of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

<sup>3</sup> TAS Case Advocacy, Figure 4.1.4, *Top 10 Issues for Cases Received in TAS, FYs 2015-2016, infra*.



- Current ISRP exemption procedures impose an unnecessary burden on taxpayers requesting religious exemptions;
- APTC recipients who receive large lump sum payments of Social Security Disability Insurance (SSDI) may be caught off guard by having to repay APTC amounts, as well as penalties and interest;
- Whether employees in the newly-established ACA Business Exam unit would receive specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as applicable large employer (ALE), MEC, and employer shared responsibility payment (ESRP); and
- Whether the IRS would be prepared to handle the additional volume of information-reporting data expected as a result of the ACA provisions impacting businesses becoming effective for the 2017 filing season.

## ANALYSIS OF PROBLEM

### Background: Filing Season (FS) 2016 Overall Results

The ACA was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, the ACA provides targeted tax credits for low income individuals and for small businesses, while imposing a personal responsibility on individuals to have health coverage.<sup>4</sup> During the 2016 filing season, eligible individual taxpayers claimed the PTC on TY 2015 returns. The following figure provides preliminary data through August 25, 2016 regarding the extent to which individual taxpayers claimed the PTC on their TY 2015 returns.

**FIGURE 1.20.1, Reporting of the Premium Tax Credit on Forms 8962 for TY 2015 Returns Through August 25, 2016<sup>5</sup>**

|   |  |
|---|--|
| Returns Filed with Forms 8962, Premium Tax Credit (PTC)       | 5.7 million                                    |
| Total PTC Amount Claimed                                      | \$17.1 billion                                 |
| Average PTC Amount Claimed Per Return                         | \$2,999  |
| Returns Reporting Advanced PTC                                | 5.3 million<br>(94% of returns with Form 8962) |
| Total Advanced PTC Reported                                   | \$18.9 billion                                 |
| Prepared Returns Filed With Forms 8962<br>(Paid or Volunteer) | 3.6 million<br>(62% of returns with Form 8962) |

4 ACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by HCERA, Pub. L. No. 111-152, 124 Stat. 1029 (2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).

5 IRS response to TAS information request (Nov. 4, 2016). This data is based on returns that had posted as of the end of August 2016, and is preliminary and subject to change as the IRS reviews the data, processes additional tax year (TY) 2015 returns, and conducts compliance activities.

Individual taxpayers who did not have MEC or qualify for an exemption were required to make an ISRP on their TY 2015 returns. The following figure provides preliminary data through August 25, 2016 on the reporting of ISRPs on TY 2015 returns.

**FIGURE 1.20.2, Reporting of Individual Shared Responsibility Payments (ISRP) on TY 2015 Returns Through August 25, 2016<sup>6</sup>**

|   |                   |
|---|-------------------|
| Returns With ISRP   | 6.1 million       |
| Average ISRP  | \$452             |
| Prepared Returns Reporting ISRP (Paid or Volunteer)                                     | 3.9 million (64%) |
| Returns Filed With Forms 8965, Health Coverage Exemptions                               | 12.2 million      |
| Returns Filed With Forms 8965 Claiming Household Coverage Exemption (Form 8965 Part II) | 3.6 million       |
| Returns Filed With Forms 8965 Claiming Coverage Exemption (Part III)                    | 8.6 million       |
| Prepared Returns Filed With Forms 8965  | 6.6 million (54%) |

### The IRS Systemically Addressed Tax Year 2014 Individual Shared Responsibility Payment (ISRP) Overpayments

In the 2015 Annual Report to Congress, the National Taxpayer Advocate raised concerns about the significant number of taxpayers who overstated the ISRP on TY 2014 returns.<sup>7</sup> Between mid-November 2015 and early January 2016, the IRS issued Letters 5600-C, *Overstated SRP Letter*, to almost 319,000 taxpayers informing them of the potential overpayment and instructing them to file an amended return and attach Form 8965, *Health Coverage Exemptions*, if applicable.<sup>8</sup>

The IRS subsequently performed a systemic ISRP “recovery” to abate the ISRP on approximately 151,000 returns for the following taxpayers who did not appear to owe the ISRP for TY 2014:<sup>9</sup>

- Taxpayers who did not claim their personal exemption; and
- Taxpayers with gross income below the filing threshold.

We will continue to work with the IRS to determine whether this recovery resolved most of the TY 2014 overpayments. The IRS has stated that it currently has no plans to address TY 2015 ISRP overstatements

<sup>6</sup> IRS response to TAS information request (Nov. 4, 2016). This data is based on returns that had posted as of the end of August 2016, and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2015 returns, and conducts compliance activities.

<sup>7</sup> National Taxpayer Advocate 2015 Annual Report to Congress 167-79. For TY 2014, over 400,000 taxpayers overstated their ISRP, totaling over \$50 million. The average Individual Shared Responsibility Payment (ISRP) overstatement was approximately \$123 per return (this average only includes returns with an ISRP overstatement). IRS Wage and Investment Research and Analysis (currently Wage and Investment Strategies and Solutions) analysis on ISRP overstatements, through cycle 34 (Aug. 27, 2015), on file with TAS Research. The IRS cannot calculate the exact amount of ISRP overpayments until all dependents have filed their TY 2014 tax returns (the amount of the ISRP depends on household income (HHI) pursuant to IRC § 5000A(c)).

<sup>8</sup> IRS response to TAS information request 6 (Nov. 4, 2016).

<sup>9</sup> IRS response to TAS fact check (Dec. 19, 2016); IRS response to TAS information request 6 (Nov. 4, 2016); IRS, Servicewide Electronic Research Program (SERP) Alert 16A0229, SRP Adjustments – Work Stoppage Effective Immediately (Aug. 5, 2016, rev. Aug. 19, 2016).

due to the small volume. It attributes this significant reduction to outreach conducted to tax practitioners and software providers.<sup>10</sup> We encourage the IRS to continue performing this outreach for future tax years.

### Taxpayers Are Seeking TAS Assistance for Premium Tax Credit (PTC) Issues

Taxpayers claiming the APTC are required to file Form 8962, *Premium Tax Credit (PTC)*, to reconcile the APTC received during the year with the PTC the taxpayer is actually entitled to receive. Taxpayers use Form 1095-A, *Health Insurance Marketplace Statement*, to prepare Form 8962. When the taxpayer files the return, the IRS ACA Verification System (AVS) checks the Marketplace Exchange Periodic Data (EPD)<sup>11</sup> on all individual tax returns to verify if the taxpayer received the APTC and reconciled the APTC on Form 8962.<sup>12</sup> If AVS indicates that the taxpayer received APTC but the taxpayer does not reconcile APTC on Form 8962, the IRS will correspond with the taxpayer by issuing Letter 12C, *Individual Return Incomplete for Processing: Forms 1040, 1040A, & 1040EZ*, and hold the return in an Error Resolution/Rejected Returns unit pending a response.<sup>13</sup>

PTC cases quickly became the fourth highest category of TAS case receipts during FY 2016.<sup>14</sup> In FY 2016, TAS received 10,910 cases with PTC issues. In comparison, TAS received 3,318 PTC cases in FY 2015 — an approximately 229 percent increase over a one-year period.<sup>15</sup> To better understand the cause of the increase, TAS's ACA Rapid Response Team analyzed a random sample of cases. A primary issue leading to the increase in PTC case receipts was that returns were held in the Wage and Investment (W&I) Error Resolution System (ERS) to process taxpayers' response to the IRS Letter 12C. The Letter 12C requested information necessary to process returns with a discrepancy or a missing Form 8962. Specifically, the analysis found the following:<sup>16</sup>

- 90 percent involved the IRS ERS/Reject unit;
- 87 percent did not reconcile the APTC. Of these cases, three percent involved APTC paid on a policy under another individual's name (not the taxpayer or spouse);
- 83 percent involved an unfiled Form 8962;
- 20 percent involved math error, Automated Questionable Credit, or an Examination issue; and

10 IRS response to TAS information request 7 (Nov. 4, 2016). As of Cycle 26, the first cycle of July 2016, the number of tax returns received with an over-assessed individual SRPs related to dependents and income below the filing threshold was approximately 6,000 in TY 2015.

11 The IRS receives Exchange Periodic Data (EPD) from the exchanges, stores the EPD in the Coverage Data Repository (CDR), and uses the EPD to verify the accuracy of the maintained data to verify Premium Tax Credit (PTC) claimed by taxpayers. Submission Processing uses the IRS ACA Verification System (AVS) to identify mismatches between taxpayer and third party data. Internal Revenue Manual (IRM) 21.6.3.4.2.13.3, *At-Filing Overview* (Oct. 1, 2015). For a detailed description of the EPD and CDR, see Treasury Inspector General for Tax Administration, *Affordable Care Act – Coverage Data Repository: Risks With Systems Development and Deployment*, Ref. No. 2015-23-041 (June 2, 2015).

12 IRM 3.14.1.6.9.13(2) (Jan. 1, 2016); IRM 21.6.3.4.2.16.3 (Oct. 1, 2015).

13 IRS response to TAS fact check (Dec. 19, 2016).

14 TAS Case Advocacy, *Figure 4.1.4, Top 10 Issues for Cases Received in TAS, FYs 2015-2016, infra*.

15 *Id.*; Business Performance Management System (BPMS), Receipts - Core Issues by Business Operating Division (BOD) & Criteria – Cumulative, FY 2016: 1-October through 12-September (10/01/2016); Business Performance Management System (BPMS), Receipts – Core Issues by BOD & Criteria – Cumulative, FY 2015: 1-October through 12-September (10/01/2015).

16 Unless otherwise indicated, the data in this discussion are drawn from a random sample of 400 cases with a PTC primary or secondary issue code from a population of 8,009 cases TAS received between October 2015 and April 2016. TAS reviewers used an electronic data collection instrument (DCI) to record data from case history reviews from the Taxpayer Advocate Management Information System (TAMIS). Thirty-four cases were excluded from the results because three taxpayers withdrew their cases from TAS and 31 cases were miscoded with a PTC issue code. Cases contained multiple issues so the percentages will not total to a 100 percent. The results are statistically valid at the 95 percent confidence level with a margin of error no greater than +/- 5 percent. Business Objects TAMIS report (April 2016).



- 12 percent involved Marketplace-related issues, such as bad data transmitted to the IRS, missing Forms 1095-A, *Health Insurance Marketplace Statement*, or Form 1095-A errors.

These numbers are not surprising given the considerable PTC compliance activities conducted by the IRS. Between January and August 2016, the IRS received approximately 1.7 million returns on which the taxpayers did not reconcile APTC received by reporting it on Form 8962. In response, the IRS issued Letters 12C to this group of taxpayers. About 50 percent of these taxpayers responded to the IRS with information needed to reconcile the APTC. In addition to the other compliance treatments discussed herein (including the issuance of Letters 12C and holding returns in ERS), the following chart sets forth the W&I audit numbers for PTC returns for FS 2016 through August 2016:<sup>17</sup>

**FIGURE 1.20.3, Premium Tax Credit Compliance Issues**

|                                   |        |
|-----------------------------------|--------|
| New Start PTC Exams TY 2014 (W&I) | 23,354 |
| New Start PTC Exams TY 2015 (W&I) | 25,418 |
| PTC Exam Closures TY 2014 (W&I)   | 20,410 |
| PTC Exam Closures TY 2015 (W&I)   | 1,967  |

The IRS receives monthly information from the Marketplace, which may include corrections, so in some cases, the taxpayer's information may have been updated since the IRS sent Letter 12C.<sup>18</sup> Some cases may simply require a subsequent review of the Coverage Data Repository (CDR) for updated information. If a subsequent review of the CDR shows an update since the issuance of Letter 12C and confirms that the information reported on the return is correct, the IRS should continue processing the return. If a review of the CDR does not show any updates and does not confirm the information reported on the tax return, the taxpayer must contact the Marketplace for a corrected Form 1095-A. Taxpayers impacted by this issue have sought assistance from TAS but the IRS should build in procedures to perform subsequent reviews of these cases to avoid unnecessary delays and reduce burden on taxpayers.

TAS has recommended the IRS reject electronic filed returns when the taxpayer received APTC but did not reconcile. This approach would allow taxpayers to reconcile their returns immediately and re-file electronically, thereby minimizing return processing delays.

### *Delays Involved in Processing Returns for Advanced Premium Tax Credit (APTC) Recipients Who Incorrectly Filed Form 1040EZ*

During FS 2016 through August, the IRS received almost 223,000 Forms 1040EZ, *Income Tax Return for Single and Joint Filers with No Dependents*, from APTC recipients.<sup>19</sup> When APTC recipients incorrectly file Form 1040EZ, they do not file the required Form 8962 to reconcile the APTC amounts received. As

<sup>17</sup> Information received from the ACA Office (Dec. 27, 2016). IRS response to TAS information request 2-5 (Nov. 4, 2016). The data includes W&I exam starts and closures through August 2016. It does not include Small Business/Self Employed Division (SB/SE) exam starts and closures.

<sup>18</sup> IRS response to TAS fact check (Dec. 19, 2016); SERP, *Responding to PTC Letters, 12C* – Paragraph 5, Note (last update Mar. 25, 2016). The IRS has posted information on its website for taxpayers who receive Letters 12C. See IRS, *Understanding Your Letter 0012C*, <https://www.irs.gov/individuals/understanding-your-letter-0012c> (last visited June 3, 2016). In addition, the IRS has posted information to assist impacted taxpayers who received corrected or voided Form 1095-A. See IRS, *Corrected or Voided Form 1095-A*, <https://www.irs.gov/Affordable-Care-Act/Individuals-and-Families/Corrected-or-Voided-Form-1095A> (last visited June 3, 2016).

<sup>19</sup> IRS response to TAS information request (Nov. 4, 2016) (the IRS was unable to provide data on the number of days to resolve these conversion issues).

a result, when they file Form 1040EZ, taxpayers experience an additional delay in getting their return processed. After the taxpayers provide the IRS with Form 8962 and other documents for reconciliation, the IRS must convert the Form 1040EZ to a Form 1040, and the additional time needed for the conversion process resulted in processing delays.<sup>20</sup>

### IRS Future Actions on “Silent Returns”

The IRS plans to reject electronically filed “silent returns” beginning in FY 2017.<sup>21</sup> Silent returns are ones for which the taxpayer did not: 1) check the box on the return to indicate the tax family had full-year health care coverage, 2) complete and attach Form 8965, *Health Coverage Exemptions*, to show tax family members had exemptions from health coverage requirements, or 3) self-assess an ISRP on the return. Silent returns filed by paper will go to the Error Resolution/Rejected Returns unit as the IRS issues Letter 12C, informing the taxpayer of the issue.<sup>22</sup> If the taxpayer does not respond to the Letter 12C, the IRS will issue a notice to inform the taxpayer that the IRS estimated an ISRP and made an adjustment accordingly. If the taxpayer’s original return claimed a refund, the IRS will offset the refund with the ISRP balance.<sup>23</sup>

If the taxpayer responds to the Letter 12C with an ISRP amount, the IRS will issue a notice to inform the taxpayer that it changed the refund amount, or the amount owed on the tax return, based on the ISRP provided in the response. If the taxpayer responds with an ISRP amount that equals more than the maximum assessment, the IRS will issue a notice to inform the taxpayer that it reduced the ISRP down to the maximum.<sup>24</sup> Finally, if the taxpayer believes that he or she is eligible for an ISRP exemption, Letter 12C instructs the taxpayer to submit Form 8965. If the taxpayer provides Form 8965, then Submission Processing will process it.<sup>25</sup>

### Current Procedures Impose Unnecessary Burden on Taxpayers Requesting Religious Exemptions for the Individual Shared Responsibility Payment (ISRP)

Internal Revenue Code (IRC) § 5000A sets forth various exemptions from the ISRP, one of which is the exemption for religious conscience. Specifically, an individual can obtain an exemption for any month in which he or she is a member of a recognized sect or division that is recognized by the Social Security Administration (SSA) as conscientiously opposed to accepting any insurance benefits, including Medicare and Social Security.<sup>26</sup> Members of these religious groups, including the Amish and Mennonites, already request an exemption from Social Security and Medicare taxes on IRS Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*. The taxpayer files the form directly with the SSA, which makes the exemption determination and then forwards the form to the IRS.<sup>27</sup>

Despite the fact that the ACA defines the ISRP exemption through reference to the social security tax provision, to receive an ISRP exemption, eligible taxpayers are required by regulation to apply to the

20 Systemic Advocacy Management System (SAMS) 34625 and 34628.

21 IRS response to TAS information request (Nov. 4, 2016).

22 *Id.* IRM 3.12.3.14, *Error Code 157* (Jan. 1, 2017).

23 IRM 3.12.3.14.1.5, *No Reply Procedures* (EC 157, SRP) (Jan. 1, 2017); IRM Exhibit 3.12.3-2, *Taxpayer Notice Codes* (Jan. 1, 2017).

24 IRM 3.12.3.14.1.4, *Reply Procedures* (EC 157, SRP) (Jan. 1, 2017).

25 *Id.*

26 IRC §§ 5000A(d)(2); 1402(g)(1).

27 IRM 4.19.6.4.1, *Form 4029 – Procedures* (Dec. 14, 2015).

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**By streamlining Affordable Care Act exemption procedures to claim an Individual Shared Responsibility Payment exemption for these taxpayers, the IRS would save both the taxpayers and the Marketplace time and paperwork and reduce confusion.**

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relevant health insurance marketplace for an exemption certification number (ECN).<sup>28</sup> The taxpayer must then enter the ECN on Form 8965, *Health Coverage Exemptions*, to claim the exemption.<sup>29</sup>

Through the National Taxpayer Advocate Public Forums, it has come to our attention that thousands of Amish constituents have applied for and have never received ECNs despite repeated attempts to contact the insurance Marketplace and responding to requests for missing information. Marketplace employees are unable to locate and provide correct information for the ECN application process in a timely manner. There is a five page ECN application required at the birth of an eligible individual and another four page application for a new ECN when the individual turns 21 years old. The procedure is time-consuming, confusing, and redundant given the well-established IRS Form 4029 process for the exemption from Social Security and Medicare taxes.<sup>30</sup>

A less burdensome solution would be to discard the ECN application process and allow taxpayers to enter “4029 exempt” instead of an ECN on Form 8965. The IRS would be able to verify the information internally, because it already receives the Form 4029 from SSA. By streamlining the ACA exemption procedures to claim an ISRP exemption for these taxpayers, the IRS would save both the taxpayers and the marketplace time and paperwork and reduce confusion.<sup>31</sup> To address this issue, the National Taxpayer Advocate has included in this report a related legislative recommendation.<sup>32</sup>

### **Treasury Has Concluded There Is No Administrative Fix for Issues With Lump Sum Social Security Disability Insurance (SSDI)**

When taxpayers receive lump sum Social Security Disability Insurance (SSDI) payments, the additional income may push their household income (HHI) above 400 percent of the federal poverty line for the applicable family size, which will make them ineligible for the PTC.<sup>33</sup> For those taxpayers who received APTC during the tax year, they will need to repay the entire amount because the repayment limitations do not apply if HHI is above the 400 percent federal poverty line threshold.<sup>34</sup> The National Taxpayer Advocate raised concerns about this issue in her 2015 Annual Report to Congress as well as her FY 2017 Objectives Report.<sup>35</sup> In addition, Senator Angus S. King (I-Maine) raised this issue in a letter to the Secretary of Treasury and Commissioner of Internal Revenue John Koskinen.<sup>36</sup>

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28 45 C.F.R. § 155.605.

29 IRS, *Individual Shared Responsibility Provision – Exemptions: Claiming or Reporting*, <https://www.irs.gov/affordable-care-act/individuals-and-families/aca-individual-shared-responsibility-provision-exemptions#Exemptions> and *Who Grants Them* (last visited Aug. 22, 2016).

30 Oral Statement of Wayne H. Wengerd, Director, Old Order Amish Steering Committee, National Taxpayer Advocate Public Forum 27-29 (Aug. 16, 2016); Luca Gattoni-Celli, *Amish Community Leader Describes IRS Challenges At TAS Forum*, TAX NOTES (Aug. 17, 2016).

31 Luca Gattoni-Celli, *Amish Community Leader Describes IRS Challenges at TAS Forum*, TAX NOTES (Aug. 17, 2016).

32 See Legislative Recommendation: *Streamline Religious Exemptions: Streamline the Religious Exemption Process for the Individual Shared Responsibility Payment (ISRP)*, *infra*.

33 IRC § 36B(c)(1)(A).

34 IRC § 36B(f)(2).

35 National Taxpayer Advocate 2015 Annual Report to Congress 167-79; National Taxpayer Advocate FY 2017 Objectives Report to Congress 141-42.

36 A copy of the letter is posted at <https://www.king.senate.gov/download/?id=E7B96C93-2D10-4B01-B8FD-31FCA4ACAA51&inline=file> (last visited Apr. 13, 2016).

TAS requested that the Office of Chief Counsel consider issuing guidance to relieve the financial burden administratively. However, subsequent to this request, the Office of Legislative Affairs in the Department of Treasury responded to the aforementioned letter from Senator King and indicated that it cannot identify an administrative basis to exclude retroactive lump sum SSDI payments from the calculation of modified adjusted gross income for purposes of the PTC and APTC. Treasury's response also indicated that it is continuing to review this issue.<sup>37</sup> Based on this response, it is unlikely that the Office of Chief Counsel will grant TAS's request for relief through administrative guidance, in which case we will consider pursuing a legislative recommendation. In the meantime, TAS Systemic Advocacy is working on a project to better educate the public on the consequences of receiving lump sum payments, including SSDI payments.

### **The IRS Has Yet to Fully Develop Training to Employees Responsible for Making Employer Shared Responsibility Payment (ESRP) Assessments on Applicable Large Employers (ALEs)**

Certain provisions of the ACA that impact employers became effective in TY 2015. Employers and the IRS have had a few years to digest the new requirements, but 2016 was the first year some of these provisions came into play.

#### *Applicable Large Employers (ALEs)*

IRC § 4980H(a)(1) imposes an assessable payment if an ALE fails to offer its full-time employees (and dependents) an opportunity to enroll in MEC under an eligible employer-sponsored plan, and PTC was paid to at least one full-time employee. In general, an employer is considered an ALE if it employs 50 or more full-time employees, or a combination of full-time and part-time employees that equals at least 50 full-time equivalents (FTEs).<sup>38</sup>

An employer calculates its full-time employees based on each employee's hours of service. For purposes of the ESRP, an employee is considered full-time for a calendar month if he or she averages at least 30 hours of service per week. Under the final regulations, for purposes of determining full-time employee status, 130 hours of service in a calendar month is treated as the monthly equivalent of at least 30 hours of service per week.<sup>39</sup>

#### *Employer Shared Responsibility Payment (ESRP)*

IRC § 4980H provides that ALEs will be subject to an ESRP if (1) it fails to offer its full-time employees the opportunity to enroll in MEC under an eligible employer-sponsored plan, and (2) a PTC was paid to at least one full-time employee. The amount of the ESRP under IRC § 4980H(a) is \$2,000 per full-time employee per year (determined on a monthly basis).<sup>40</sup> If an ALE offers MEC but it is not considered affordable, it will be assessed an ESRP of \$3,000 for each employee (determined on a monthly basis) that purchases health insurance from the exchange and is granted a tax credit and/or subsidy for health insurance.<sup>41</sup>

37 Treasury Addresses Treatment of Retroactive SSDI Payments, TAX NOTES TODAY (Aug. 31, 2016).

38 IRC § 4980H(c)(2).

39 Treas. Reg. § 54.4890H, 79 FR 8543 (Feb. 12, 2014), [www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage](http://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage).

40 IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5).

41 IRC § 4980H(b)(1).

### *Minimum Essential Coverage (MEC) and Minimum Value*

MEC and minimum value relate to the determination of ESRP. MEC is defined in IRC § 5000A(f) and the regulations under that section, and includes employer-provided health care coverage. IRC § 36B(c)(2)(C)(ii) provides the definition of minimum value. An employer-sponsored health plan meets this standard if it is designed to pay at least 60 percent of the total cost of medical services for a standard population.

Although the IRS developed and delivered a substantial amount of training prior to the 2016 filing season, much of that training focused on the components of the ACA that affected individual taxpayers.<sup>42</sup> With certain provisions of the ACA impacting employers becoming effective for the 2015 tax year, the IRS has to ensure that its employees who work ACA-related issues are properly trained on the aspects of the ACA that impact business taxpayers.

For example, ALEs not in compliance with the provisions under IRC § 4980H may be subject to an assessable payment, referred to as the ESRP. These ESRP cases will be worked by a special group of Employment Tax Compliance Officers.<sup>43</sup> The training for this group will be delivered in January 2017.<sup>44</sup> The training materials are currently under development, so TAS did not have an opportunity to review them for completeness and whether they adequately protect taxpayer rights.

### **The Inability of the IRS to Adequately Test the Accuracy of Information Reporting Data Before the Filing Season May Cause Significant Taxpayer Burden**

The IRS relies on information reports to verify data relevant to the ESRP liability and eligibility for the Small Business Health Care Tax Credit. IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. IRC § 6056 requires annual information reporting by ALEs relating to the health insurance that the employer offers (or does not offer) to its full-time employees. Below is a list of information returns the IRS created to meet these reporting requirements:

- Form 1095-B, *Health Coverage* (used by health insurance issuers and carriers to report information about individuals who are covered by MEC and therefore aren't liable for the individual shared responsibility payment; due to the IRS by February 28 (or March 31 if filing electronically));<sup>45</sup>
- Form 1094-B, *Transmittal of Health Coverage* (used by health insurance issuers and carriers to submit Form 1095-B);
- Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage Insurance* (furnished by ALEs to any full-time employee for one or more months of the year; due to the IRS by February 28 (or March 31 if filing electronically));<sup>46</sup> and
- Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns* (used by ALEs to submit Form 1095-C).

<sup>42</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 71.

<sup>43</sup> IRS response to TAS information request (Nov. 4, 2016).

<sup>44</sup> *Id.*

<sup>45</sup> IRS, *Instructions for Forms 1094-B and 1095-B* (2015), [www.irs.gov/pub/irs-pdf/i109495b.pdf](http://www.irs.gov/pub/irs-pdf/i109495b.pdf).

<sup>46</sup> IRS, *Instructions for Forms 1094-C and 1095-C* (2015), [www.irs.gov/pub/irs-pdf/i109495c.pdf](http://www.irs.gov/pub/irs-pdf/i109495c.pdf).

The IRS was not equipped to test the accuracy of information reporting data before the 2016 filing season. Prior to the 2016 filing season, the IRS had estimated that it would receive and process an estimated 77 million new Forms 1095-C from ALEs.<sup>47</sup> By the end of August, the IRS had received substantially more than this estimated amount — approximately 104 million — with 5.4 percent of such Forms 1095-C being rejected.<sup>48</sup> Reasons for rejected returns include faulty transmission validation, missing (or multiple) attachments, error reading the file, or duplicate files.<sup>49</sup>

The IRS had little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers. Furthermore, without legislative action from Congress, the IRS is not able to expand the taxpayer identification number (TIN) matching program to include health insurers and self-insured employers that are required to file Form 1095-B, which may lead to mismatches and unnecessary notices.<sup>50</sup>

If the IRS receives incomplete or inaccurate data, taxpayers will be harmed.<sup>51</sup> For example, ALEs may unnecessarily be required to substantiate coverage to employees if the data is unreliable and contains false positives. If the IRS receives inaccurate data regarding coverage, it may erroneously assess ESRPs on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify.

## CONCLUSION

The IRS has made significant progress on the implementation of the tax provisions of the ACA. The 2016 filing season was especially challenging for the IRS as it implemented several ACA provisions that impacted employers and processed a significant amount of new information returns from insurers and ALEs. TAS commits to continue actively working with the IRS to ensure that taxpayer rights are protected, especially as the IRS implements the remaining compliance initiatives surrounding these provisions. We are concerned that TAS PTC case receipts spiked over the past year and will evaluate administrative and legislative fixes to resolve the underlying issues in an effort to reduce taxpayer burden.

TAS will continue to address ACA-related issues as they arise and identify systemic problems. TAS will assign ACA Rapid Response Team members to immediately address any potential ACA systemic issues that arise. In addition, we encourage both internal and external stakeholders to report any suspected ACA systemic issues on TAS's Systemic Advocacy Management System.<sup>52</sup>

47 IRS response to TAS information request (Oct. 22, 2015).

48 IRS response to TAS information request (Nov. 4, 2016). After the initial rejection, the transmitter could have resubmitted the Form 1095-C and gotten through.

49 *Id.*

50 See National Taxpayer Advocate 2015 Annual Report to Congress 167-79 (Most Serious Problem: *The IRS Is Compromising Taxpayers Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*); National Taxpayer Advocate 2015 Annual Report to Congress 383-88 (Legislative Recommendation: *Affordable Care Act Information Reporting: Allow Taxpayer Identification Number Matching for Filers of Information Returns Under IRC §§ 6055 and 6056*).

51 See National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Math Error Authority: Limit the IRS's Summary Assessment Authority*); National Taxpayer Advocate 2014 Annual Report to Congress 75-76 (discussing TIN matching for Form 1095-B; the IRS will use Form 1095-B to verify compliance with IRC § 5000A).

52 Stakeholders can report suspected systemic issues at [www.irs.gov/sams](http://www.irs.gov/sams).



## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Apply the ISRP overpayment recovery procedures used for TY 2014 to TY 2015 ISRP overpayments and to overpayments made in future tax years.
2. Take preventive measures to avoid ISRP overpayments in the future, such as distributing educational notices to preparers associated with overpayments and conducting a comprehensive review and testing of private-sector tax filing software to ensure that the overpayment problems do not recur.
3. Reject electronic filed returns when the taxpayer received APTC and did not reconcile on Form 8962, *Premium Tax Credit (PTC)*, as the IRS plans to do for silent returns that do not include Form 8965, *Health Coverage Exemptions*.
4. Develop procedures to perform reviews of cases for which the IRS issued Letter 12C to determine if the CDR has been updated with new Marketplace data.
5. Ensure instructions to the Form 1040 series returns and the Form 8962 clearly state that the taxpayer cannot file Form 1040EZ if the APTC was paid on the taxpayer's behalf.
6. Conduct outreach and education on the consequences of receiving large lump sum SSDI distributions to APTC recipients and the Social Security Administration.

## INTRODUCTION: Legislative Recommendations

Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The chart immediately following this introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2015 Annual Reports.<sup>1</sup> The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion highlights several bills introduced during the 114th Congress relating to the National Taxpayer Advocate's proposals.

### TAXPAYER PROTECTION ACT OF 2016

On July 12, 2016, Senator Hatch introduced the Taxpayer Protection Act of 2016, which would enact several of the National Taxpayer Advocate's past proposals, including:<sup>2</sup>

- **Extending the time limit for contesting an IRS levy.**<sup>3</sup> This provision would amend IRC § 6343(b) to extend the time to return levied funds or proceeds from nine months to two years. It would also amend IRC § 6532(c) to extend the period within which a third party can bring a suit for return of levied funds or proceeds from nine months to two years.<sup>4</sup>
- **Individuals held harmless on improper levies on retirement plans.**<sup>5</sup> This provision would hold individuals harmless on improper levies on individual retirement plans.<sup>6</sup>
- **Return preparation programs for low income taxpayers.**<sup>7</sup> The legislation would establish a Community Volunteer Income Tax Assistance Matching Grant Program (VITA grant program). The VITA grant program would be administered in a manner that is substantially similar to the Community Volunteer Income Tax Assistance matching grants demonstration program established under Title I of Division D of the Consolidated Appropriations Act, 2008. In addition, the legislation would authorize the Secretary to promote the benefits of, and encourage the use of, tax preparation through the VITA program through the use of mass communications, referrals, and

1 An electronic version of the figure is available on the TAS website at [www.TaxpayerAdvocate.irs.gov/Reports](http://www.TaxpayerAdvocate.irs.gov/Reports). The figure lists all legislative recommendations the National Taxpayer Advocate has made since 2001 and identifies each section of the Internal Revenue Code (IRC) affected by the recommendations.

2 Taxpayer Protection Act of 2016, S. 3156, 114th Cong. (2016).

3 S. 3156, § 103, 114th Cong. (2016).

4 See National Taxpayer Advocate 2001 Annual Report to Congress 202-09 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

5 S. 3156, § 104, 114th Cong. (2016).

6 See National Taxpayer Advocate 2001 Annual Report to Congress 202-14 (Legislative Recommendation: *Reinstatement of Retirement Account*).

7 S. 3156, § 111, 114th Cong. (2016). On March 22, 2016, Representative Honda introduced the Volunteer Income Tax Assistance (VITA) Act, which contains the same provisions. See Volunteer Income Tax Assistance (VITA) Act, H.R. 4835, 114th Cong. (2016).

other means.<sup>8</sup> It would also encourage VITA grant recipients to refer eligible taxpayers to local or regional Low Income Taxpayer Clinics.<sup>9</sup> Finally, the legislation would allow the IRS to refer taxpayers to qualified VITA programs.<sup>10</sup>

- **Clarification of equitable relief from joint liability.**<sup>11</sup> This provision would clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.<sup>12</sup>
- **Modification of user fee requirements for installment agreements.**<sup>13</sup> This provision would waive the installment agreement fee for taxpayers whose adjusted gross incomes do not exceed 250 percent of the federal poverty level.<sup>14</sup>
- **Whistleblower reforms.**<sup>15</sup> This provision would amend IRC § 7623 to include anti-retaliation protection for tax whistleblowers.<sup>16</sup> It would also impose a penalty on whistleblowers for unauthorized disclosure of tax information.<sup>17</sup>
- **Notification to exempt organizations prior to revoking exempt status for failing to file information returns.**<sup>18</sup> This provision would amend IRC § 6033(j) to require the IRS to notify exempt organizations that have not filed an annual notice or return for two consecutive years that the IRS has no record of receiving a return or notice and that the organization's exemption will be revoked if it does not file by the next filing deadline.<sup>19</sup>
- **Single point of contact for identity theft victims.**<sup>20</sup> This provision would require the IRS to establish new procedures to ensure that any taxpayer whose return has been delayed or otherwise adversely affected due to identity theft has a single point of contact at the IRS throughout the processing of his or her case. The single point of contact would be required to track the taxpayer's

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- 8 See National Taxpayer Advocate 2014 Annual Report to Congress 55-66 (Most Serious Problem: *VITA/TCE Funding: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*).
- 9 See National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*); National Taxpayer Advocate 2007 Annual Report to Congress 551-53 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).
- 10 See National Taxpayer Advocate 2007 Annual Report to Congress 551-53 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).
- 11 S. 3156, § 113, 114th Cong. (2016).
- 12 See National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*).
- 13 S. 3156, § 114, 114th Cong. (2016).
- 14 See National Taxpayer Advocate 2006 Annual Report to Congress 141-56 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*) (recommending the IRS implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required).
- 15 S. 3156, § 122, 114th Cong. (2016).
- 16 See National Taxpayer Advocate 2015 Annual Report to Congress 409-12 (Legislative Recommendation: *Whistleblower Program: Enact Anti-Retaliation Legislation to Protect Tax Whistleblowers*).
- 17 See National Taxpayer Advocate 2015 Annual Report to Congress 413-18 (Legislative Recommendation: *Whistleblower Program: Make Unauthorized Disclosures of Return Information by Whistleblowers Subject to the Penalties of IRC §§ 7431, 7213, and 7213A, Substantially Increase the Amount of Such Penalties, and Make Whistleblowers Subject to the Safeguarding Requirement of IRC § 6103(p)*).
- 18 S. 3156, § 144, 114th Cong. (2016).
- 19 See National Taxpayer Advocate 2011 Annual Report to Congress 444 (Most Serious Problem: *Status Update: The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*). The provision also requires the IRS to retroactively reinstate an exempt organization, without the organization reapplying, if it can demonstrate that it did not receive notification and it files a return or notice for the current year.
- 20 S. 3156, § 201, 114th Cong. (2016).

case from start to finish and coordinate with other specialized units to resolve case issues as quickly as possible.<sup>21</sup>

- **Notification of suspected identity theft.**<sup>22</sup> This provision would require the IRS to notify taxpayers of suspected identity theft, including employment-related identity theft.<sup>23</sup>

## TAXPAYER PROTECTION ACT OF 2016

On April 12, 2016, Representative Lewis introduced legislation, also entitled the Taxpayer Protection Act of 2016, which would enact several of the National Taxpayer Advocate's recommendations from her 2015 Annual Report, including:<sup>24</sup>

- **Repeal of suspension of period of limitations during the pending of an application for a Taxpayer Assistance Order (TAO).**<sup>25</sup> This provision would repeal IRC § 7811(d), which currently suspends the statute of limitations during the period beginning on the date of a taxpayer's TAO application and ending on the date of the National Taxpayer Advocate's decision with respect to such application as well as any period specified by the National Taxpayer Advocate in a TAO issued pursuant to the TAO application.<sup>26</sup>
- **Limitation on levies on retirement savings.**<sup>27</sup> This provision would amend IRC § 6334(a) to exempt from levy any individual's interest in a qualified retirement plan before the individual has attained normal retirement age (or 65 in the case of an individual retirement account or a plan that does not specify a normal retirement age) or after the attainment of retirement age (or 65) if the levy would create an economic hardship (within the meaning of IRC § 6343(a)(1)(D)) due to the financial condition of the taxpayer. The provision also contains an exception to the limitation on retirement plan levies for flagrant acts, which are situations where the IRS determines a taxpayer filed a fraudulent return or acted with the intent to evade or defeat any tax or its collection or payment.<sup>28</sup>
- **Tolling of limitation on levy recoveries for disabled taxpayers.**<sup>29</sup> This provision would amend IRC § 6343(b) to suspend the nine-month period of limitations for the IRS to return wrongfully levied proceeds during any period where the taxpayer is financially disabled (as defined in IRC § 6511(h)). It would also amend IRC § 6532(c)(1) to suspend the nine-month period for a third-party individual to file a civil suit for the return of wrongfully levied proceeds during any period where the individual is financially disabled (as defined in section 6511(h)).<sup>30</sup>

21 See National Taxpayer Advocate 2013 Annual Report to Congress 83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*).

22 S. 3156, § 205, 114th Cong. (2016).

23 See National Taxpayer Advocate 2011 Annual Report to Congress 61 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*).

24 Taxpayer Protection Act of 2016, H.R. 4912, 114th Cong. (2016).

25 H.R. 4912, § 202, 114th Cong. (2016).

26 See National Taxpayer Advocate 2015 Annual Report to Congress 316-28 (Legislative Recommendation: *Statute of Limitations: Repeal or Fix Statute Suspension Under IRC § 7811(d)*).

27 H.R. 4912, § 203, 114th Cong. (2016).

28 See National Taxpayer Advocate 2015 Annual Report to Congress 340-45 (Legislative Recommendation: *Levies on Retirement Accounts: Amend IRC § 6334 to Include a Definition of Flagrancy and Require Consideration of Basic Living Expenses at Retirement Before Levying on Retirement Accounts*).

29 H.R. 4912, § 204, 114th Cong. (2016).

30 See National Taxpayer Advocate 2015 Annual Report to Congress 368-75 (Legislative Recommendation: *Taxpayer Rights: Toll the Time Period for Financially Disabled Taxpayers to Request Return of Levy Proceeds to Better Protect Their Right to a Fair and Just Tax System*).

- **Extension of period to withdraw a frivolous submission.**<sup>31</sup> This provision would amend IRC § 6702(b)(3) to expand the notice period, from 30 days to 60 days, in which taxpayers may correct their returns and avoid application of the frivolous return penalty.<sup>32</sup>

This bill also contains several of the National Taxpayer Advocate's proposals from Annual Reports prior to 2015, including:

- **Repeal of rules relating to tax collection contracts.**<sup>33</sup> This provision would repeal the private debt collection provisions contained in IRC §§ 6306 and 6307.<sup>34</sup> The National Taxpayer Advocate had previously identified private debt collection as a most serious problem and recommended that these provisions be repealed.<sup>35</sup>
- **Repeal of partial payment requirement for submissions of offers-in-compromise.**<sup>36</sup> This provision would repeal the current partial payment requirement on submissions of offers-in-compromise under IRC § 7122(c).<sup>37</sup> In addition, this provision would add a new section to IRC § 7122 to apply any user fee for an offer-in-compromise to reduce the tax which is the subject of that offer.<sup>38</sup>
- **Taxpayer notification of suspected identity theft.**<sup>39</sup> This provision would require the IRS to notify taxpayers of suspected identity theft.<sup>40</sup>
- **Single point of contact for identity theft victims.**<sup>41</sup> Like the provision discussed above, this provision would require the IRS to establish new procedures to ensure that any taxpayer whose return has been delayed or otherwise adversely affected due to identity theft has a single point of contact at the IRS throughout the processing of his or her case. The single point of contact would be required to track the taxpayer's case from start to finish and coordinate with other specialized units to resolve case issues as quickly as possible.<sup>42</sup>

31 H.R. 4912, § 205, 114th Cong. (2016).

32 See National Taxpayer Advocate 2015 Annual Report to Congress 376-82 (Legislative Recommendation: *The Frivolous Return Penalty: Protect Good Faith Taxpayers by Expanding the Availability of Penalty Reductions, Establishing Specific Penalty Abatement Procedures, and Providing Appeal Rights*).

33 H.R. 4912, § 101, 114th Cong. (2016).

34 See Fixing America's Surface Transportation Act, Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-36 (2015) (FAST Act).

35 See National Taxpayer Advocate 2005 Annual Report to Congress 76-93 (Most Serious Problem: *Training of Private Debt Collection Employees*); National Taxpayer Advocate 2006 Annual Report to Congress 34-61, 458-62 (Most Serious Problem: *True Costs and Benefits of Private Debt Collection and Legislative Recommendation: Repeal Private Debt Collection Provisions*). For the National Taxpayer Advocate's concerns about the IRS's implementation of the current private debt collection program, see Most Serious Problem: *Private Debt Collection (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship*, *supra*.

36 H.R. 4912, § 206, 114th Cong. (2016).

37 See National Taxpayer Advocate 2006 Annual Report to Congress 507-19 (Legislative Recommendation: *Improve Offer in Compromise Eligibility*).

38 H.R. 4912, § 206, 114th Cong. (2016).

39 *Id.* at section 301.

40 See National Taxpayer Advocate 2011 Annual Report to Congress at 61 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*).

41 H.R. 4912, § 302, 114th Cong. (2016).

42 See National Taxpayer Advocate 2013 Annual Report to Congress at 83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*).

- **Referrals to low income taxpayer clinics permitted.**<sup>43</sup> This provision would amend IRC § 7526(c) to allow IRS employees to refer taxpayers for advice and assistance to qualified low income taxpayer clinics receiving funding under this section.<sup>44</sup>
- **Regulation of tax return preparers.**<sup>45</sup> The National Taxpayer Advocate has recommended that Congress authorize the IRS to create an effective oversight and penalty regime for return preparers.<sup>46</sup> This provision would amend 31 U.S.C. § 330 to allow for the regulation of tax return preparers. It would also give the IRS the authority to sanction regulated tax return preparers and provide a definition of the term “tax return preparer.”

## STOLEN IDENTITY REFUND FRAUD PREVENTION ACT

The National Taxpayer Advocate has discussed the problems of identity theft and the IRS’s procedures for addressing it in several of her past Annual Reports.<sup>47</sup> On July 12, 2016, Senator Hatch introduced the Stolen Identity Refund Fraud Prevention Act, a bill dedicated to identity theft issues.<sup>48</sup> This bill would require the IRS, in consultation with the National Taxpayer Advocate, to develop and implement publicly available guidelines for management of cases involving stolen identity refund fraud in a manner that reduces the administrative burden on taxpayers who are victims of such fraud.<sup>49</sup> The bill would also require the IRS to notify taxpayers of suspected identity theft, including employment-related identity theft.<sup>50</sup> In addition, the bill would enhance the IRS’s Identity Protection Personal Identification Number (IP PIN) program and require the IRS, not later than July 1, 2019, to issue, upon request, an IP PIN to any requesting individual after the individual’s identity has been verified to the satisfaction of the IRS.<sup>51</sup>

43 H.R. 4912, § 303, 114th Cong. (2016).

44 See National Taxpayer Advocate 2007 Annual Report to Congress 551–53 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

45 H.R. 4912, § 401, 114th Cong. (2016).

46 See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2008 Annual Report to Congress 423-26 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*).

47 For a comprehensive history and discussion of the identity theft problem, see National Taxpayer Advocate 2015 Annual Report to Congress 180-87 (Most Serious Problem: *Identity Theft (IDT): The IRS’s Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long*).

48 Stolen Identity Refund Fraud Prevention Act, S. 3157, 114th Cong. (2016).

49 S. 3157, § 101, 114th Cong. (2016).

50 *Id.* at section 104; see National Taxpayer Advocate 2011 Annual Report to Congress 61 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*).

51 S. 3157, § 202, 114th Cong. (2016).



## National Taxpayer Advocate Legislative Recommendations With Congressional Action

| Alternative Minimum Tax (AMT)   |                          |           |            |  |
|---|--------------------------|-----------|------------|--|
| <b>Repeal the Individual AMT</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 82–100; National Taxpayer Advocate 2004 Annual Report to Congress 383–85; National Taxpayer Advocate 2008 Annual Report to Congress 356–62. | Repeal the AMT outright. |           |            |  |
|   | Bill Number              | Sponsor   | Date       | Status   |
| Legislative Activity 113th Congress   | S 1616                   | Lee       | 10/30/2013 | Referred to the Finance Committee  |
|   | HR 243                   | Ross      | 1/14/2013  | Referred to the Ways & Means Committee   |
| Legislative Activity 112th Congress   | HR 86                    | Bachmann  | 1/5/2011   | Referred to the Ways & Means Committee   |
|   | HR 99                    | Dreler    | 1/5/2011   | Referred to the Ways & Means Committee   |
|   | HR 547                   | Garrett   | 2/8/2011   | Referred to the Ways & Means Committee   |
|   | HR 3400                  | Garrett   | 11/10/2011 | Referred to the Ways & Means Committee   |
|   | S 727                    | Wyden     | 4/5/2011   | Referred to the Finance Committee  |
|   | S 820                    | Shelby    | 4/14/2011  | Referred to the Finance Committee  |
|   | HR 3804                  | Huelskamp | 1/23/2012  | Referred to the Ways & Means Committee   |
| Legislative Activity 111th Congress   | S 3018                   | Wyden     | 2/23/2010  | Referred to the Finance Committee  |
|   | HR 240                   | Garrett   | 1/7/2009   | Referred to the Ways & Means Committee   |
|   | HR 782                   | Paul      | 1/28/2009  | Referred to the Ways & Means Committee   |
|   | S 932                    | Shelby    | 4/30/2009  | Referred to the Finance Committee  |
| Legislative Activity 110th Congress   | S 55                     | Baucus    | 1/4/2007   | Referred to the Finance Committee  |
|   | S 14                     | Kyl       | 4/17/2007  | Referred to the Finance Committee  |
|   | S 1040                   | Shelby    | 3/29/2007  | Referred to the Finance Committee  |
|   | HR 1366                  | English   | 3/7/2007   | Referred to the Ways & Means Committee   |
|   | HR 1942                  | Garrett   | 4/19/2007  | Referred to the Ways & Means Committee   |
|   | HR 3970                  | Rangel    | 10/25/2007 | Referred to the Ways & Means Committee   |
|   | S 2293                   | Lott      | 11/1/2007  | Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464 |
| Legislative Activity 109th Congress   | HR 1186                  | English   | 3/9/2005   | Referred to the Ways & Means Committee   |
|   | S 1103                   | Baucus    | 5/23/2005  | Referred to the Finance Committee  |
|   | HR 2950                  | Neal      | 6/16/2005  | Referred to the Ways & Means Committee   |
|   | HR 3841                  | Manzullo  | 9/2/2005   | Referred to the Ways & Means Committee   |
| Legislative Activity 108th Congress   | HR 43                    | Collins   | 1/7/2003   | Referred to the Ways & Means Committee   |
|   | HR 1233                  | English   | 3/12/2003  | Referred to the Ways & Means Committee   |
|   | S 1040                   | Shelby    | 5/12/2003  | Referred to the Finance Committee  |
|   | HR 3060                  | N. Smith  | 9/10/2003  | Referred to the Ways & Means Committee   |
|   | HR 4131                  | Houghton  | 4/2/2004   | Referred to the Ways & Means Committee   |
|   | HR 4164                  | Shuster   | 4/2/2004   | Referred to the Ways & Means Committee   |
| Legislative Activity 107th Congress   | HR 437                   | English   | 2/6/2001   | Referred to the Ways & Means Committee   |
|   | S 616                    | Hutchison | 3/26/2002  | Referred to the Finance Committee  |
|   | HR 5166                  | Portman   | 7/18/2002  | Referred to the Ways & Means Committee   |

|   |             |   |            |  |
|---|-------------|---|------------|--|
| <b>Index AMT for Inflation</b>                                    |             | If full repeal of the individual AMT is not possible, it should be indexed for inflation.   |            |  |
| National Taxpayer Advocate 2001 Annual Report to Congress 82–100. |             |   |            |  |
|   | Bill Number | Sponsor   | Date       | Status   |
| Legislative Activity 111th Congress                               | S 3223      | McConnell   | 9/13/2010  | Placed on the Senate Calendar  |
|   | HR 5077     | Hall  | 4/20/2010  | Referred to the Ways & Means Committee   |
|   | HR 719      | Lee   | 1/27/2009  | Referred to the Ways & Means Committee   |
|   | S 722       | Baucus  | 3/26/2009  | Referred to the Finance Committee  |
| Legislative Activity 110th Congress                               | HR 1942     | Garrett   | 4/19/2007  | Referred to the Ways & Means Committee   |
| Legislative Activity 109th Congress                               | HR 703      | Garrett   | 2/9/2005   | Referred to the Ways & Means Committee   |
|   | HR 4096     | Reynolds  | 10/20/2005 | 12/7/2005 Passed the House;<br>12/13/2005 Placed on the Senate<br>Legislative Calendar |
| Legislative Activity 108th Congress                               | HR 22       | Houghton  | 1/7/2003   | Referred to the Ways & Means Committee   |
| Legislative Activity 107th Congress                               | HR 5505     | Houghton  | 10/1/2002  | Referred to the Ways & Means Committee   |
| <b>Eliminate Several Adjustments for Individual AMT</b>           |             | Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes. |            |  |
| National Taxpayer Advocate 2001 Annual Report to Congress 82–100. |             |   |            |  |
|   | Bill Number | Sponsor   | Date       | Status   |
| Legislative Activity 112th Congress                               | S 336       | DeMint  | 2/14/2011  | Referred to the Finance Committee  |
| Legislative Activity 110th Congress                               | S 102       | Kerry   | 1/4/2007   | Referred to the Finance Committee  |
| Legislative Activity 109th Congress                               | S 1861      | Harkin  | 10/7/2005  | Referred to the Finance Committee  |
| Legislative Activity 108th Congress                               | HR 1939     | Neal  | 5/12/2003  | Referred to the Ways & Means Committee   |
| <b>Private Debt Collection (PDC)</b>                              |             |   |            |  |
| <b>Repeal PDC Provisions</b>                                      |             | Repeal IRC § 6306, thereby terminating the PDC initiative.  |            |  |
| National Taxpayer Advocate 2006 Annual Report to Congress 458–62. |             |   |            |  |
|   | Bill Number | Sponsor   | Date       | Status   |
| Legislative Activity 114th Congress                               | HR 4912     | Lewis   | 4/12/2016  | Referred to the Ways & Means Committee   |
| Legislative Activity 111th Congress                               | HR 796      | Lewis   | 2/3/2009   | Referred to the Ways & Means Committee   |
| Legislative Activity 110th Congress                               | HR 5719     | Rangel  | 4/16/2008  | Referred to the Finance Committee  |
|   | S 335       | Dorgan  | 1/18/2007  | Referred to the Finance Committee  |
|   | HR 695      | Van Hollen  | 1/24/2007  | Referred to the Ways & Means Committee   |
|   | HR 3056     | Rangel  | 7/17/2007  | 10/10/2007 Passed the House;<br>10/15/2007 Referred to the Finance<br>Committee        |

## Tax Preparation and Low Income Taxpayer Clinics (LITC)

**Matching Grants Program for Return Preparation**

National Taxpayer Advocate 2002 Annual Report to Congress vii–viii.

Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.

Legislative Activity 114th Congress

**Pub. L. No. 114-113, Division E (2015).**

| Bill Number | Sponsor | Date       | Status   |
|-------------|---------|------------|--|
| S 3156      | Hatch   | 7/12/2016  | Placed on Senate Legislative Calendar under General Orders |
| HR 4835     | Honda   | 3/22/2016  | Referred to the Ways & Means Committee                     |
| S 2333      | Cardin  | 11/30/2015 | Referred to the Finance Committee                          |
| HR 4128     | Becerra | 11/30/2015 | Referred to the Ways & Means Committee                     |

Legislative Activity 113th Congress

**Pub. L. No. 113-235, Division E, 128 STAT. 2130, 2336 (2014).**

Legislative Activity 111th Congress

**Pub. L. No. 111-117, Div. C, Title I, 123 Stat. 3034, 3163 (2009).**

Legislative Activity 110th Congress

**Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).**

| Bill Number | Sponsor  | Date      | Status                                 |
|-------------|----------|-----------|--|
| HR 5716     | Becerra  | 4/8/2008  | Referred to the Ways & Means Committee |
| S 1219      | Bingaman | 4/25/2007 | Referred to the Finance Committee      |
| S 1967      | Clinton  | 8/2/2007  | Referred to the Finance Committee      |

Legislative Activity 109th Congress

|        |          |           |  |
|--------|----------|-----------|--|
| HR 894 | Becerra  | 2/17/2005 | Referred to the Financial Institutions and Consumer Credit Subcommittee  |
| S 832  | Bingaman | 4/18/2005 | Referred to the Finance Committee  |
| S 1321 | Santorum | 6/28/2005 | 9/15/2006 Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614 |

Legislative Activity 108th Congress

|         |          |           |   |
|---------|----------|-----------|---|
| S 476   | Grassley | 2/27/2003 | Referred to the Finance Committee   |
| S 685   | Bingaman | 3/21/2003 | Referred to the Finance Committee   |
| S 882   | Baucus   | 4/10/2003 | 5/19/2004 S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882 |
| HR 1661 | Rangel   | 4/8/2003  | Referred to the Ways & Means Committee  |
| HR 3983 | Becerra  | 3/17/2004 | Referred to the Ways & Means Committee  |

Legislative Activity 107th Congress

|         |          |           |  |
|---------|----------|-----------|--|
| HR 586  | Lewis    | 2/13/2001 | 4/18/2002 Passed the House with an amendment; referred to the Senate             |
| HR 3991 | Houghton | 3/19/2001 | Referred to the Ways & Means Committee   |
| HR 7    | Baucus   | 7/16/2002 | Reported by Chairman Baucus with an amendment; referred to the Finance Committee |

| <b>Referrals to LITCs</b><br>National Taxpayer Advocate 2007 Annual Report to Congress 551–53.  |  |          |            |   |
|---|--|----------|------------|---|
|   | Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance.  |          |            |   |
|   | Bill Number  | Sponsor  | Date       | Status  |
| Legislative Activity 114th Congress   | HR 4912  | Lewis    | 4/12/2016  | Referred to the Ways & Means Committee  |
|   | S 2333   | Cardin   | 11/30/2015 | Referred to the Finance Committee   |
|   | HR 4128  | Becerra  | 11/30/2015 | Referred to the Ways & Means Committee  |
| Legislative Activity 112th Congress   | S 1573   | Durbin   | 9/15/2011  | Placed on the Senate Legislative Calendar under General Orders; Calendar No. 171  |
|   | S 3355   | Bingaman | 6/28/2012  | Referred to the Finance Committee   |
|   | HR 6050  | Becerra  | 6/28/2012  | Referred to the Ways & Means Committee  |
| Legislative Activity 111th Congress   | HR 4994  | Lewis    | 4/13/2010  | Referred to the Ways & Means Committee  |
|   | S 3215   | Bingaman | 4/15/2010  | Referred to the Finance Committee   |
|   | HR 5047  | Becerra  | 4/15/2010  | Referred to the Ways & Means Committee  |
| Legislative Activity 110th Congress   | HR 5719  | Rangel   | 4/16/2008  | Referred to the Finance Committee   |
| <b>Regulation of Income Tax Return Preparers</b><br>National Taxpayer Advocate 2002 Annual Report to Congress 216–30;<br>National Taxpayer Advocate 2003 Annual Report to Congress 270–301;<br>National Taxpayer Advocate 2007 Annual Report to Congress 83–95 & 140–55;<br>National Taxpayer Advocate 2008 Annual Report to Congress 423–26;<br>National Taxpayer Advocate 2009 Annual Report to Congress 41–69;<br>National Taxpayer Advocate 2009 Annual Report to Congress 60–74. |  |          |            |   |
|   | Create an effective oversight and penalty regime for return preparers by taking the following steps: <ul style="list-style-type: none"> <li>♦ Enact a registration, examination, certification, and enforcement program for federal tax return preparers;</li> <li>♦ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight;</li> <li>♦ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and</li> <li>♦ Require the IRS to take steps within its existing administrative authority, including requiring a checkbox on all returns in which preparers would enter their category of return preparer (i.e., attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections.</li> </ul> |          |            |   |
|   | Bill Number  | Sponsor  | Date       | Status  |
| Legislative Activity 114th Congress   | HR 4912  | Lewis    | 4/12/2016  | Referred to the Ways & Means Committee  |
|   | S 2333   | Cardin   | 11/30/2015 | Referred to the Finance Committee   |
|   | HR 4128  | Becerra  | 11/30/2015 | Referred to the Ways & Means Committee  |
| Legislative Activity 112th Congress   | S 3355   | Bingaman | 6/28/2012  | Referred to the Finance Committee   |
|   | HR 6050  | Becerra  | 6/28/2012  | Referred to the Ways & Means Committee  |
| Legislative Activity 111th Congress   | S 3215   | Bingaman | 4/15/2010  | Referred to the Finance Committee   |
|   | HR 5047  | Becerra  | 4/15/2010  | Referred to the Ways & Means Committee  |
| Legislative Activity 110th Congress   | HR 5716  | Becerra  | 4/8/2008   | Referred to the Ways & Means Committee  |
|   | S 1219   | Bingaman | 4/25/2007  | Referred to the Finance Committee   |
| Legislative Activity 109th Congress   | HR 894   | Becerra  | 2/17/2005  | Referred to the Financial Institutions and Consumer Credit Subcommittee   |
|   | S 832  | Bingaman | 4/18/2005  | Referred to the Finance Committee   |
|   | S 1321   | Santorum | 6/28/2005  | 9/15/2006 Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336<br>9/15/2006 Placed on Senate Legislative Calendar under General Orders; Calendar No. 614 |

|  |   |          |            |   |
|--|---|----------|------------|---|
| Legislative Activity 108th Congress  | S 685   | Bingaman | 3/21/2003  | Referred to the Finance Committee   |
|  | S 882   | Baucus   | 4/10/2003  | 5/19/2004 S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882 |
|  | HR 3983   | Becerra  | 3/17/2004  | Referred to the Ways & Means Committee  |
| <b>Identity Theft</b>  |   |          |            |   |
| <b>Single Point of Contact</b>   |   |          |            |   |
| National Taxpayer Advocate 2013 Annual Report to Congress 61.  | Designate a single point of contact for identity theft victims to work with the identity theft victim until all related issues are resolved.  |          |            |   |
|  | Bill Number   | Sponsor  | Date       | Status  |
| Legislative Activity 114th Congress  | S 3157  | Hatch    | 7/12/2016  | Placed on Senate Legislative Calendar under General Orders  |
|  | S 3156  | Hatch    | 7/12/2016  | Referred to Finance Committee   |
|  | HR 4912   | Lewis    | 4/12/2016  | Referred to the Ways & Means Committee  |
|  | S 767   | Nelson   | 3/9/2015   | Referred to Finance Committee   |
| Legislative Activity 113th Congress  | S 2736  | Hatch    | 7/31/2014  | Referred to Finance Committee   |
| <b>Notification of Suspected Identity Theft</b>  |   |          |            |   |
| National Taxpayer Advocate 2011 Annual Report 75-83.   | Require the IRS to notify taxpayers of suspected identity theft, including employment-related identity identity.  |          |            |   |
|  | Bill Number   | Sponsor  | Date       | Status  |
| Legislative Activity 114th Congress  | S 3157  | Hatch    | 7/12/2016  | Referred to Finance Committee   |
|  | S 3156  | Hatch    | 7/12/2016  | Placed on Senate Legislative Calendar under General Orders  |
|  | HR 4912   | Lewis    | 4/12/2016  | Referred to the Ways & Means Committee  |
| <b>Public Awareness Campaign for Low Income Taxpayer Clinics</b>   |   |          |            |   |
| National Taxpayer Advocate 2014 Annual Report to Congress 411-16;<br>National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 1-26;<br>National Taxpayer Advocate 2007 Annual Report to Congress 551-53. | Authorize the Secretary to promote the benefits of and encourage the use of qualified LITCs through the use of mass communications, referrals, and other means.   |          |            |   |
|  | Bill Number   | Sponsor  | Date       | Status  |
| Legislative Activity 114th Congress  | S 2333  | Cardin   | 11/30/2015 | Referred to the Finance Committee   |
|  | HR 4128   | Becerra  | 11/30/2015 | Referred to the Ways & Means Committee  |
| <b>Public Awareness Campaign on Registration Requirements</b>  |   |          |            |   |
| National Taxpayer Advocate 2002 Annual Report to Congress 216-30.  | Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards. |          |            |   |
|  | Bill Number   | Sponsor  | Date       | Status  |
| Legislative Activity 111th Congress  | S 3215  | Bingaman | 4/15/2010  | Referred to the Finance Committee   |
|  | HR 5047   | Becerra  | 4/15/2010  | Referred to the Ways & Means Committee  |
| Legislative Activity 110th Congress  | HR 5716   | Becerra  | 4/8/2008   | Referred to the Ways & Means Committee  |
|  | S 1219  | Bingaman | 4/25/2007  | Referred to the Finance Committee   |

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| Legislative Activity 109th Congress  | HR 894   | Becerra         | 2/17/2005 | Referred to the Financial Institutions and Consumer Credit Subcommittee   |
|  | S 832  | Bingaman        | 4/18/2005 | Referred to the Finance Committee   |
|  | S 1321   | Santorum        | 6/28/2005 | 9/15/2006 Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614    |
| Legislative Activity 108th Congress  | S 685  | Bingaman        | 3/21/2003 | Referred to the Finance Committee   |
|  | S 882  | Baucus          | 4/10/2003 | 5/19/2004 S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882   |
|  | HR 3983  | Becerra         | 3/17/2004 | Referred to the Ways & Means Committee  |
| <b>Increase Preparer Penalties</b><br>National Taxpayer Advocate 2003 Annual Report to Congress 270–301. <div>Strengthen oversight of all preparers by enhancing due diligence and signature requirements, increasing the dollar amount of preparer penalties, and assessing and collecting those penalties, as appropriate.</div> |  |                 |           |   |
| Legislative Activity 112th Congress  |  |                 |           |   |
|  | Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011). |                 |           |   |
|  | Bill Number  | Sponsor         | Date      | Status  |
| Legislative Activity 111th Congress  | S 3215   | Bingaman        | 4/15/2010 | Referred to the Finance Committee   |
|  | HR 5047  | Becerra         | 4/15/2010 | Referred to the Ways & Means Committee  |
| Legislative Activity 110th Congress  | HR 5719  | Rangel          | 4/16/2008 | Referred to the Finance Committee   |
|  | HR 4318  | Crowley/Ramstad | 12/6/2007 | Referred to the Ways & Means Committee  |
|  | S 2851   | Bunning         | 4/14/2008 | Referred to the Finance Committee   |
|  | S 1219   | Bingaman        | 4/25/2007 | Referred to the Finance Committee   |
| Legislative Activity 109th Congress  | HR 894   | Becerra         | 2/17/2005 | Referred to the Financial Institutions and Consumer Credit Subcommittee   |
|  | S 832  | Bingaman        | 4/18/2005 | Referred to the Finance Committee   |
|  | S 1321   | Santorum        | 6/28/2005 | 9/15/2006 Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336<br>9/15/2006 Placed on Senate Legislative Calendar under General Orders; Calendar No. 614 |
| Legislative Activity 108th Congress  | S 685  | Bingaman        | 3/21/2003 | Referred to the Finance Committee   |
|  | S 882  | Baucus          | 4/10/2003 | 5/19/2004 S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882   |
|  | HR 3983  | Becerra         | 3/17/2004 | Referred to the Ways & Means Committee  |



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| <b>Refund Delivery Options</b>  |  | Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options. |            |   |
| National Taxpayer Advocate 2008 Report to Congress 427–41.  |  |   |            |   |
|   | Bill Number  | Sponsor   | Date       | Status  |
| Legislative Activity 112th Congress   | S 3355   | Bingaman  | 6/28/2012  | Referred to the Finance Committee                       |
|   | HR 6050  | Becerra   | 6/28/2012  | Referred to the Ways & Means Committee                  |
| Legislative Activity 111th Congress   | S 3215   | Bingaman  | 4/15/2010  | Referred to the Senate Finance Committee                |
|   | HR 5047  | Becerra   | 4/15/2010  | Referred to the Ways & Means Committee                  |
|   | HR 4994  | Lewis   | 4/13/2010  | Referred to the Ways & Means Committee                  |
| <b>Small Business Issues</b>  |  |   |            |   |
| <b>Health Insurance Deduction/Self-Employed Individuals</b>   |  | Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.   |            |   |
| National Taxpayer Advocate 2001 Annual Report to Congress 223;<br>National Taxpayer Advocate 2008 Annual Report to Congress 388–89. |  |   |            |   |
| Legislative Activity 111th Congress   | <b>Pub. L. No. 111-240, § 2504 STAT 2560 (2010).</b>                     |   |            |   |
|   | Bill Number  | Sponsor   | Date       | Status  |
|   | S 725  | Bingaman  | 3/26/2009  | Referred to the Finance Committee                       |
|   | HR 1470  | Kind  | 3/12/2009  | Referred to the Ways & Means Committee                  |
| Legislative Activity 110th Congress   | S 2239   | Bingaman  | 10/25/2007 | Referred to the Finance Committee                       |
| Legislative Activity 109th Congress   | S 663  | Bingaman  | 3/17/2005  | Referred to the Finance Committee                       |
|   | S 3857   | Smith   | 9/16/2006  | Referred to the Finance Committee                       |
| Legislative Activity 108th Congress   | HR 741   | Sanchez   | 2/12/2003  | Referred to the Ways & Means Committee                  |
|   | HR 1873  | Manzullo Velazquez  | 4/30/2003  | Referred to the Ways & Means Committee                  |
| Legislative Activity 107th Congress   | S 2130   | Bingaman  | 4/15/2002  | Referred to the Finance Committee                       |
| <b>Married Couples as Business Co-owners</b>  |  | Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of subchapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.  |            |   |
| National Taxpayer Advocate 2002 Annual Report to Congress 172–84.   |  |   |            |   |
| Legislative Activity 110th Congress   | <b>Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).</b> |   |            |   |
|   | Bill Number  | Sponsor   | Date       | Status  |
| Legislative Activity 109th Congress   | HR 3629  | Doggett   | 7/29/2005  | Referred to the Ways & Means Committee                  |
|   | HR 3841  | Manzullo  | 9/2/2005   | Referred to the Ways & Means Committee                  |
| Legislative Activity 108th Congress   | HR 1528  | Portman   | 6/20/2003  | 5/19/2004 Passed/agreed to in Senate, with an amendment |
|   | S 842  | Kerry   | 4/9/2003   | Referred to the Finance Committee                       |
|   | HR 1640  | Udall   | 4/3/2003   | Referred to the Ways & Means Committee                  |
|   | HR 1558  | Doggett   | 4/2/2003   | Referred to the Ways & Means Committee                  |
| <b>Income Averaging for Commercial Fishermen</b>  |  | Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.   |            |   |
| National Taxpayer Advocate 2001 Annual Report to Congress 226.  |  |   |            |   |
| Legislative Activity 108th Congress   | <b>Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).</b>          |   |            |   |

|   |   |          |            |  |
|---|---|----------|------------|--|
| <b>Election to Be Treated as an S Corporation</b><br><br>National Taxpayer Advocate 2004 Annual Report to Congress 390–93.    | Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, <i>U.S. Income Tax Return for an S Corporation</i> .   |          |            |  |
|   | Bill Number   | Sponsor  | Date       | Status   |
| Legislative Activity 112th Congress   | S 2271  | Franken  | 3/29/2012  | Referred to the Finance Committee  |
| Legislative Activity 109th Congress   | HR 3629   | Doggett  | 7/29/2005  | Referred to the Ways & Means Committee   |
|   | HR 3841   | Manzullo | 9/2/2005   | Referred to the Ways & Means Committee   |
| <b>Regulation of Payroll Tax Deposits Agents</b><br><br>National Taxpayer Advocate 2004 Annual Report to Congress 394–99.     | <ul style="list-style-type: none"><li>♦ Amend the Code to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees;</li><li>♦ Amend IRC § 3504 to require agents with an approved Form 2678, <i>Employer/Payer Appointment of Agent</i>, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause; and</li><li>♦ Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.</li></ul> |          |            |  |
| Legislative Activity 114th Congress   | <b>Pub. L. No. 114-113, Division E, § 106 (2015).</b>   |          |            |  |
|   | Bill Number   | Sponsor  | Date       | Status   |
| Legislative Activity 113th Congress   | S 900   | Mikulski | 05/08/2013 | Referred to the Finance Committee  |
| Legislative Activity 110th Congress   | S 1773  | Snowe    | 7/12/2007  | Referred to the Finance Committee  |
| Legislative Activity 109th Congress   | S 3583  | Snowe    | 6/27/2006  | Referred to the Finance Committee  |
|   | S 1321  | Santorum | 6/28/2005  | 9/15/2006 The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614 |
| <b>Issue Dual Address Change Notice</b><br><br>National Taxpayer Advocate 2004 Annual Report to Congress 394–99.              | Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address).   |          |            |  |
| Legislative Activity 114th Congress   | <b>Pub. L. No. 114-113, Division E, § 106 (2015).</b>   |          |            |  |
| Legislative Activity 113th Congress   | <b>Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).</b>  |          |            |  |
| <b>Special Consideration for Offer in Compromise</b><br><br>National Taxpayer Advocate 2004 Annual Report to Congress 394–99. | Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.  |          |            |  |
| Legislative Activity 113th Congress   | <b>Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).</b>  |          |            |  |

## Simplification

**Reduce the Number of Tax Preferences**

National Taxpayer Advocate 2010 Annual Report to Congress 365–72.

Simplify the complexity of the tax code generally by reducing the number of tax preferences.

|                                     | Bill Number | Sponsor | Date     | Status                            |
|-------------------------------------|-------------|---------|----------|-----------------------------------|
| Legislative Activity 112th Congress | S 727       | Wyden   | 4/5/2011 | Referred to the Finance Committee |

**Simplify and Streamline Education Tax Incentives**

National Taxpayer Advocate 2008 Annual Report to Congress 370–72;  
National Taxpayer Advocate 2004 Annual Report to Congress 403–22.

Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221; (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer; (3) the definitions for “Qualified Higher Education Expenses” and “Eligible Education Institution” should be simplified; (4) the income level and phase-out calculations should be more consistent under the various provisions; (5) all dollar amounts should be indexed for inflation; and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.

|                                     | Bill Number | Sponsor | Date       | Status                                 |
|-------------------------------------|-------------|---------|------------|--|
| Legislative Activity 114th Congress | S 699       | Schumer | 3/10/2015  | Referred to the Finance Committee      |
|                                     | HR 1260     | Doggett | 3/4/2015   | Referred to the Ways & Means Committee |
| Legislative Activity 113th Congress | S 835       | Schumer | 4/25/2013  | Referred to the Finance Committee      |
|                                     | HR 1738     | Doggett | 4/25/2013  | Referred to the Ways & Means Committee |
|                                     | HR 3476     | Israel  | 11/13/2013 | Referred to the Ways & Means Committee |
| Legislative Activity 112th Congress | S 727       | Wyden   | 4/5/2011   | Referred to the Finance Committee      |
|                                     | S 3267      | Schumer | 6/6/2012   | Referred to the Finance Committee      |
|                                     | HR 6522     | Israel  | 9/21/2012  | Referred to the Ways & Means Committee |

**Simplify and Streamline Retirement Savings Tax Incentives**

National Taxpayer Advocate 2008 Annual Report to Congress 373–74;  
National Taxpayer Advocate 2004 Annual Report to Congress 423–32.

Consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement plan for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.

|                                     | Bill Number | Sponsor | Date     | Status                            |
|-------------------------------------|-------------|---------|----------|-----------------------------------|
| Legislative Activity 112th Congress | S 727       | Wyden   | 4/5/2011 | Referred to the Finance Committee |

## Tax Gap Provisions

**Corporate Information Reporting**

National Taxpayer Advocate 2008 Annual Report to Congress 388.

Require businesses that pay \$600 or more during the year to non-corporate and corporate service providers to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.

|                                     | Bill Number | Sponsor | Date       | Status  |
|-------------------------------------|-------------|---------|------------|---|
| Legislative Activity 111th Congress | S 1796      | Baucus  | 10/19/2009 | 10/19/2009 Placed on Senate Legislative Calendar under General Orders; Calendar No. 184 |

|   |   |          |            |   |
|---|---|----------|------------|---|
| <b>Reporting on Customer's Basis in Security Transaction</b><br>National Taxpayer Advocate 2005 Annual Report to Congress 433–41.   | Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B. |          |            |   |
| Legislative Activity 110th Congress   | <b>Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).</b>   |          |            |   |
|   | Bill Number   | Sponsor  | Date       | Status  |
|   | HR 878  | Emanuel  | 2/7/2007   | Referred to the Ways & Means Committee  |
|   | S 601   | Bayh     | 2/14/2007  | Referred to the Finance Committee   |
|   | S 1111  | Wyden    | 4/16/2007  | Referred to the Finance Committee   |
|   | HR 2147   | Emanuel  | 5/3/2007   | Referred to the Ways & Means Committee  |
|   | HR 3996<br>PCS  | Rangel   | 10/30/2007 | 11/14/2007 Placed on the Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision  |
| Legislative Activity 109th Congress   | S 2414  | Bayh     | 3/14/2006  | Referred to the Finance Committee   |
|   | HR 5176   | Emanuel  | 4/25/2006  | Referred to the Ways & Means Committee  |
|   | HR 5367   | Emanuel  | 5/11/2006  | Referred to the Ways & Means Committee  |
| <b>IRS Forms Revisions</b><br>National Taxpayer Advocate 2004 Annual Report to Congress 480;<br>National Taxpayer Advocate 2010 Annual Report to Congress 40.                                     | Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC.   |          |            |   |
|   | Bill Number   | Sponsor  | Date       | Status  |
| Legislative Activity 112th Congress   | S 1289  | Carper   | 6/28/2011  | Referred to the Finance Committee   |
| <b>IRS to Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS)</b><br>National Taxpayer Advocate 2005 Annual Report to Congress 381–96.                       | Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.   |          |            |   |
|   | Bill Number   | Sponsor  | Date       | Status  |
| Legislative Activity 109th Congress   | S 1321RS  | Santorum | 6/28/2005  | 9/15/2006 The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614  |
| <b>Study of Use of Voluntary Withholding Agreements</b><br>National Taxpayer Advocate 2004 Annual Report to Congress 478–89;<br>National Taxpayer Advocate 2005 Annual Report to Congress 381-96. | Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).  |          |            |   |
|   | Bill Number   | Sponsor  | Date       | Status  |
| Legislative Activity 109th Congress   | S 1321RS  | Santorum | 6/28/2005  | 9/15/2006 The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336.<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614 |

|  |  |         |           |                                   |
|--|--|---------|-----------|-----------------------------------|
| <b>Require Form 1099 Reporting for Incorporated Service Providers</b><br>National Taxpayer Advocate 2007 Annual Report to Congress 494–96.   | Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.  |         |           |                                   |
| Legislative Activity 111th Congress  | <b>Pub. L No. 111-148 § 9006 (2010).</b><br>However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over \$600, but Require Reporting on Corporate and Certain Other Payments.                                      |         |           |                                   |
| <b>Require Financial Institutions to Report All Accounts to the IRS by Eliminating the \$10 Threshold on Interest Reporting</b><br>National Taxpayer Advocate 2007 Annual Report to Congress 501–02. | Eliminate the \$10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.  |         |           |                                   |
|  | Bill Number  | Sponsor | Date      | Status                            |
| Legislative Activity 112th Congress  | S 1289   | Carper  | 6/28/2011 | Referred to the Finance Committee |
| Legislative Activity 111th Congress  | S 3795   | Carper  | 9/16/2010 | Referred to the Finance Committee |
| <b>Revise Form 1040, Schedule C to Break Out Gross Receipts Reported on Payee Statements Such as Form 1099</b><br>National Taxpayer Advocate 2007 Annual Report to Congress 40.                      | Administrative recommendation that the IRS add a line to Schedule C, so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.   |         |           |                                   |
|  | Bill Number  | Sponsor | Date      | Status                            |
| Legislative Activity 111th Congress  | S 3795   | Carper  | 9/16/2010 | Referred to the Finance Committee |
| <b>Include a Checkbox on Business Returns Requiring Taxpayers to Verify That They Filed All Required Forms 1099</b><br>National Taxpayer Advocate 2007 Annual Report to Congress 40.                 | Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: “Did you make any payments over \$600 in the aggregate during the year to any unincorporated trade or business?” and “If yes, did you file all required Forms 1099?” S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance. |         |           |                                   |
|  | Bill Number  | Sponsor | Date      | Status                            |
| Legislative Activity 111th Congress  | S 3795   | Carper  | 9/16/2010 | Referred to the Finance Committee |
| <b>Authorize Voluntary Withholding Upon Request</b><br>National Taxpayer Advocate 2007 Annual Report to Congress 493–94.   | Authorize voluntary withholding agreements between independent contractors and service recipients.   |         |           |                                   |
|  | Bill Number  | Sponsor | Date      | Status                            |
| Legislative Activity 111th Congress  | S 3795   | Carper  | 9/16/2010 | Referred to the Finance Committee |

|   |  |          |            |  |
|---|--|----------|------------|--|
| <b>Require Backup Withholding on Certain Payments When TINs Cannot Be Validated</b><br><br>National Taxpayer Advocate 2005 Annual Report to Congress 238–48.  | Administrative recommendation that the IRS require payors to commence backup withholding if they do not receive verification of a payee's TIN. (S 3795 would require voluntary withholding on certain payments.)   |          |            |  |
|   | Bill Number  | Sponsor  | Date       | Status   |
| Legislative Activity 111th Congress   | S 3795   | Carper   | 9/16/2010  | Referred to the Finance Committee  |
| <b>Worker Classification</b><br><br>National Taxpayer Advocate 2008 Annual Report to Congress 375–90.   | Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.  |          |            |  |
|   | Bill Number  | Sponsor  | Date       | Status   |
| Legislative Activity 112th Congress   | S 1289   | Carper   | 6/28/2011  | Referred to the Finance Committee  |
| <b>Taxpayer Bill of Rights and <i>De Minimis</i> “Apology” Payments</b>   |  |          |            |  |
| <b>Taxpayer Bill of Rights</b><br><br>National Taxpayer Advocate 2014 Annual Report to Congress;<br>National Taxpayer Advocate 2013 Annual Report to Congress;<br>National Taxpayer Advocate 2011 Annual Report to Congress 493-518;<br>National Taxpayer Advocate 2007 Annual Report to Congress 478–48. | Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.  |          |            |  |
|   | <b>Pub. L. No. 114-113, Division Q § 401 (2015).</b>   |          |            |  |
| Legislative Activity 114th Congress   | Bill Number  | Sponsor  | Date       | Status   |
|   | S 2333   | Cardin   | 11/30/2015 | Referred to the Finance Committee  |
|   | HR 4128  | Becerra  | 11/30/2015 | Referred to the Ways & Means Committee   |
|   | S 1578   | Grassley | 6/16/2015  | Referred to the Finance Committee  |
|   | S 943  | Portman  | 4/15/2015  | Referred to the Finance Committee  |
|   | S 951  | Ayotte   | 4/15/2015  | Referred to the Finance Committee  |
|   | HR 1058  | Roskam   | 2/25/2015  | Passed the House of Representatives, and was referred to the Senate Finance Committee on 4/16/2015 |
| Legislative Activity 113th Congress   | HR 2768  | Roskam   | 6/22/2013  | Passed the House of Representatives, and was referred to the Senate Finance Committee on 8/31/2013 |
| Legislative Activity 112th Congress   | S 3355   | Bingaman | 6/28/2012  | Referred to the Finance Committee  |
|   | HR 6050  | Becerra  | 6/28/2012  | Referred to the Ways & Means Committee   |
| Legislative Activity 111th Congress   | S 3215   | Bingaman | 4/15/2010  | Referred to the Ways & Means Committee   |
|   | HR 5047  | Becerra  | 4/15/2010  | Referred to the Finance Committee  |
| Legislative Activity 110th Congress   | HR 5716  | Becerra  | 4/8/2008   | Referred to the Ways & Means Committee   |
| <b><i>De Minimis</i> “Apology” Payments</b><br><br>National Taxpayer Advocate 2007 Annual Report to Congress 490.   | Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide <i>de minimis</i> compensation to taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the IRC § 7811 definition of significant hardship. |          |            |  |
|   | Bill Number  | Sponsor  | Date       | Status   |
| Legislative Activity 112th Congress   | S 1289   | Carper   | 6/28/2011  | Referred to the Finance Committee  |
| Legislative Activity 111th Congress   | S 3795   | Carper   | 9/16/2010  | Referred to the Finance Committee  |



|   |   |            |            |  |
|---|---|------------|------------|--|
| <b>Toll the Time Period for Financially Disabled Taxpayers to Request Return of Levy Proceeds to Better Protect Their Right to a Fair and Just Tax System</b><br>National Taxpayer Advocate 2015 Annual Report to Congress 368-75 | Requiring Tolling for Claims of Financially Disabled Taxpayers  |            |            |  |
|   | Bill Number   | Sponsor    | Date       | Status   |
| Legislative Activity 114th Congress   | HR 4912   | Lewis      | 4/12/2016  | Referred to the Ways & Means Committee                     |
| <b>Simplify the Tax Treatment of Cancellation of Debt Income</b><br>National Taxpayer Advocate 2008 Annual Report to Congress 391-96.   | Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.  |            |            |  |
|   | Bill Number   | Sponsor    | Date       | Status   |
| Legislative Activity 111th Congress   | HR 4561   | Lewis      | 2/2/2010   | Referred to the Ways & Means Committee                     |
| <b>Joint and Several Liability</b>  |   |            |            |  |
| <b>Tax Court Review of Request for Equitable Innocent Spouse Relief</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 128-65.  | Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.   |            |            |  |
| Legislative Activity 109th Congress   | Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).  |            |            |  |
| <b>Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court</b><br>National Taxpayer Advocate 2004 Annual Report to Congress 490-92.  | Allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim. |            |            |  |
|   | Bill Number   | Sponsor    | Date       | Status   |
| Legislative Activity 114th Congress   | S 949   | Cornyn     | 4/15/2015  | Referred to the Finance Committee                          |
|   | HR 1828   | Thornberry | 4/15/2015  | Referred to the Ways & Means Committee                     |
| Legislative Activity 113th Congress   | S 725   | Cornyn     | 4/15/2013  | Referred to the Finance Committee                          |
|   | HR 3479   | Thornberry | 11/13/2013 | Referred to the Ways & Means Committee                     |
| Legislative Activity 112th Congress   | HR 4375   | Johnson    | 4/17/2012  | Referred to the Ways & Means Committee                     |
|   | S 2291  | Cornyn     | 4/17/2012  | Referred to the Ways & Means Committee                     |
| <b>Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is De Novo.</b><br>National Taxpayer Advocate 2011 Annual Report to Congress 531-36.   | Amend IRC § 6015 to specify that the scope and standard of review in tax court determinations under IRC § 6015(f) is <i>de novo</i> .   |            |            |  |
|   | Bill Number   | Sponsor    | Date       | Status   |
| Legislative Activity 114th Congress   | S 3156  | Hatch      | 7/12/2016  | Placed on Senate Legislative Calendar under General Orders |
|   | S 2333  | Cardin     | 11/30/2015 | Referred to the Finance Committee                          |
|   | HR 4128   | Becerra    | 11/30/2015 | Referred to the Ways & Means Committee                     |
|   | S 949   | Cornyn     | 4/15/2015  | Referred to the Finance Committee                          |
|   | HR 1828   | Thornberry | 4/15/2015  | Referred to the Ways & Means Committee                     |
| Legislative Activity 113th Congress   | S 725   | Cornyn     | 4/15/2013  | Referred to the Finance Committee                          |
|   | HR 3479   | Thornberry | 11/13/2013 | Referred to the Ways & Means Committee                     |

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| Legislative Activity 112th Congress   | S 2291  | Cornyn    | 4/17/2012  | Referred to the Finance Committee      |
|   | S 3355  | Bingaman  | 6/28/2012  | Referred to the Finance Committee      |
|   | HR 60550  | Becerra   | 6/28/2012  | Referred to the Ways & Means Committee |
| <b>Collection Issues</b>  |   |           |            |  |
| <b>Improve Offer In Compromise Program Accessibility</b><br>National Taxpayer Advocate 2006 Annual Report to Congress 507–19.                         |   |           |            |  |
|   | Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement. |           |            |  |
|   | Bill Number   | Sponsor   | Date       | Status                                 |
| Legislative Activity 114th Congress   | HR 4912   | Lewis     | 4/12/2016  | Referred to the Ways & Means Committee |
| Legislative Activity 112th Congress   | S 3355  | Bingaman  | 6/28/2012  | Referred to the Finance Committee      |
|   | HR 6050   | Becerra   | 6/28/2012  | Referred to the Ways & Means Committee |
|   | S 1289  | Carper    | 6/28/2011  | Referred to the Finance Committee      |
| Legislative Activity 111th Congress   | HR 4994   | Lewis     | 4/13/2010  | Referred to the Ways & Means Committee |
|   | HR 2342   | Lewis     | 5/12/2009  | Referred to the Ways & Means Committee |
| <b>Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens</b><br>2009 National Taxpayer Advocate Report to Congress 357–64. |   |           |            |  |
|   | Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFTL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.   |           |            |  |
|   | Bill Number   | Sponsor   | Date       | Status                                 |
| Legislative Activity 114th Congress   | S 2333  | Cardin    | 11/30/2015 | Referred to the Finance Committee      |
|   | HR 4128   | Becerra   | 11/30/2015 | Referred to the Ways & Means Committee |
| Legislative Activity 112th Congress   | S 3355  | Bingaman  | 6/28/2012  | Referred to the Finance Committee      |
|   | HR 6050   | Becerra   | 6/28/2012  | Referred to the Ways & Means Committee |
| Legislative Activity 111th Congress   | S 3215  | Bingaman  | 4/15/2010  | Referred to the Finance Committee      |
|   | HR 5047   | Becerra   | 4/15/2010  | Referred to the Ways & Means Committee |
|   | HR 6439   | Hastings  | 11/18/2010 | Referred to the Ways & Means Committee |
| <b>Permit the IRS to Release Levies on Small Business Taxpayers</b><br>2011 National Taxpayer Advocate Report to Congress 537–43.                     |   |           |            |  |
|   | Amend IRC § 6343(a)(1)(d) to: permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business.  |           |            |  |
|   | Bill Number   | Sponsor   | Date       | Status                                 |
| Legislative Activity 112th Congress   | HR 4368   | McDermott | 4/17/2012  | Referred to the Ways & Means Committee |

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| <b>Return of Levy or Sale Proceeds</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 202–14.  |             |            |            |  |
| Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.                           |             |            |            |  |
|  | Bill Number | Sponsor    | Date       | Status   |
| Legislative Activity 114th Congress  | S 3156      | Hatch      | 7/12/2016  | Placed on Senate Legislative Calendar under General Orders   |
|  | S 2333      | Cardin     | 11/30/2015 | Referred to the Finance Committee  |
|  | HR 4128     | Becerra    | 11/30/2015 | Referred to the Ways & Means Committee   |
|  | S 1578      | Grassley   | 6/16/2015  | Referred to the Finance Committee  |
|  | S 949       | Cornyn     | 4/15/2015  | Referred to the Finance Committee  |
|  | HR 1828     | Thornberry | 4/15/2015  | Referred to the Ways & Means Committee   |
| Legislative Activity 112th Congress  | HR 4375     | Johnson    | 4/17/2012  | Referred to the Ways & Means Committee   |
|  | S 2291      | Cornyn     | 4/17/2012  | Referred to the Finance Committee  |
| Legislative Activity 110th Congress  | HR 5719     | Rangel     | 4/16/2008  | Referred to the Finance Committee  |
|  | HR 1677     | Rangel     | 3/26/2007  | Referred to the Finance Committee  |
| Legislative Activity 109th Congress  | S 1321 RS   | Santorum   | 6/28/2005  | 9/15/2006 The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614 |
| Legislative Activity 108th Congress  | HR 1528     | Portman    | 6/20/2003  | 5/19/2004 Passed/agreed to in the Senate, with an amendment  |
|  | HR 1661     | Rangel     | 4/8/2003   | Referred to the Ways & Means Committee   |
| Legislative Activity 107th Congress  | HR 3991     | Houghton   | 3/19/2002  | Defeated in House  |
|  | HR 586      | Lewis      | 2/13/2001  | 4/18/02 Passed the House with an amendment; referred to the Senate   |
| <b>Reinstatement of Retirement Accounts</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 202–14.   |             |            |            |  |
| Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343:<br>♦ § 401 – Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans<br>♦ § 408 – Individual Retirement Account, and SEP-Individual Retirement Account<br>♦ § 408A – Roth Individual Retirement Account. |             |            |            |  |
|  | Bill Number | Sponsor    | Date       | Status   |
| Legislative Activity 114th Congress  | S 1578      | Grassley   | 6/16/2015  | Finance Committee  |
| Legislative Activity 110th Congress  | HR 5719     | Rangel     | 4/16/2008  | Referred to the Finance Committee  |
|  | HR 1677     | Rangel     | 3/26/2007  | Referred to the Finance Committee  |
| Legislative Activity 109th Congress  | S 1321RS    | Santorum   | 6/28/2005  | 9/15/2006 The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title with written report No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614  |

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| Legislative Activity 108th Congress  | HR 1528   | Portman    | 6/20/2003 | 5/19/2004 Passed/agreed to in the Senate, with an amendment  |
|  | HR 1661   | Rangel     | 4/8/2003  | Referred to the Ways & Means Committee   |
|  | S 882   | Baucus     | 4/10/2003 | 5/19/2004 S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882 |
| Legislative Activity 107th Congress  | HR 586  | Lewis      | 2/13/2001 | 4/18/2002 Passed the House with an amendment; referred to Senate                                     |
|  | HR 3991   | Houghton   | 3/19/2002 | Defeated in the House  |
| <b>Levies on Retirement Accounts</b>   |   |            |           |  |
| National Taxpayer Advocate 2015 Annual Report to Congress 340-45.              | Require the IRS to issue regulations describing a full financial analysis of the taxpayer's projected basic living expenses at retirement prior to allowing a determination to levy on a retirement account.  |            |           |  |
|  | Bill Number   | Sponsor    | Date      | Status   |
| Legislative Activity 114th Congress  | S 3156  | Hatch      | 7/12/2016 | Placed on Senate Legislative Calendar under General Orders   |
|  | HR 4912   | Lewis      | 4/12/2016 | Referred to the Ways & Means Committee   |
| <b>Consolidation of Appeals of Collection Due Process (CDP) Determinations</b> |   |            |           |  |
| National Taxpayer Advocate 2005 Annual Report to Congress 451-70.              | Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases. |            |           |  |
| Legislative Activity 109th Congress  | <b>Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).</b>   |            |           |  |
| <b>Partial Payment Installment Agreements</b>                                  |   |            |           |  |
| National Taxpayer Advocate 2001 Annual Report to Congress 210-14.              | Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the IRS.      |            |           |  |
| Legislative Activity 108th Congress  | <b>Pub. L. No. 108-357, § 833, 118 Stat. 1418, 1600 (2004).</b>   |            |           |  |
| <b>Waiver of Installment Agreement Fees for Low Income Taxpayers</b>           |   |            |           |  |
| National Taxpayer Advocate 2006 Annual Report to Congress 141-56.              | Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.   |            |           |  |
|  | Bill Number   | Sponsor    | Date      | Status   |
| Legislative Activity 114th Congress  | S 3156  | Hatch      | 7/12/2016 | Placed on Senate Legislative Calendar under General Orders   |
|  | S 949   | Cornyn     | 4/15/2015 | Referred to the Finance Committee  |
|  | HR 1828   | Thornberry | 4/15/2015 | Referred to the Ways & Means Committee   |
| Legislative Activity 112th Congress  | HR 4375   | Johnson    | 4/17/2012 | Referred to the Ways & Means Committee   |
|  | S 2291  | Cornyn     | 4/17/2012 | Referred to the Finance Committee  |

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| <b>Strengthen the Independence of the IRS Office of Appeals</b><br>National Taxpayer Advocate 2009 Annual Report to Congress 346-50.  | Strengthen the independence of the IRS Office of Appeals and require at least one appeals officer and settlement officer in each state. In addition the Office of Appeals should be independent from the IRS, should eliminate prohibited ex parte communications with the IRS.   |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 114th Congress   | S 2333  | Cardin     | 11/30/2015 | Referred to the Finance Committee                           |
|   | HR 4128   | Becerra    | 11/30/2015 | Referred to the Ways & Means Committee                      |
|   | S 1578  | Grassley   | 6/16/2015  | Referred to the Finance Committee                           |
|   | S 949   | Cornyn     | 4/15/2015  | Referred to the Finance Committee                           |
|   | HR 1828   | Thornberry | 4/15/2015  | Referred to the Ways & Means Committee                      |
| Legislative Activity 112th Congress   | HR 4375   | Johnson    | 4/17/2012  | Referred to the Ways & Means Committee                      |
|   | S 2291  | Cornyn     | 4/17/2012  | Referred to the Finance Committee                           |
| <b>Penalties and Interest</b>   |   |            |            |   |
| <b>Erroneous Refund Penalty</b><br>National Taxpayer Advocate 2014 Annual Report to Congress 351;<br>National Taxpayer Advocate 2011 Annual Report to Congress 544.   | Amend section 6676 to clarify that the penalty does not apply to individual taxpayers who acted with reasonable cause and in good faith in erroneously claiming a credit or refund. Taking into account all of taxpayers' facts and circumstances in determining whether they had such reasonable cause would bring this statutory penalty into conformity with the TBOR <i>right to a fair and just tax system</i> .   |            |            |   |
| Legislative Activity 114th Congress   | <b>Pub. L. No. 114-113, Division Q § 209 (2015).</b>  |            |            |   |
| <b>Protect Good Faith Taxpayers by Expanding the Availability of Penalty Reductions, Establishing Specific Penalty Abatement Procedures, and Providing Appeal Rights</b><br>National Taxpayer Advocate 2015 Annual Report to Congress 376-82. | Expand the notice period allowing taxpayers to correct their returns and avoid application of the frivolous return penalty from 30 days to 60 days and establish the same mechanism for correcting returns  |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 114th Congress   | HR 4912   | Lewis      | 4/12/2016  | Referred to the Ways & Means Committee                      |
| <b>Interest Rate and Failure to Pay Penalty</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 179–82.  | Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.  |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 108th Congress   | HR 1528   | Portman    | 6/20/2003  | 5/19/2004 Passed/agreed to in the Senate, with an amendment |
|   | HR 1661   | Rangel     | 4/8/2003   | Referred to the Ways & Means Committee                      |
| <b>Interest Abatement on Erroneous Refunds</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 183–87.   | Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice. |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 109th Congress   | HR 726  | Sanchez    | 2/9/2005   | Referred to the Ways & Means Committee                      |

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| Legislative Activity 108th Congress  | HR 1528  | Portman  | 6/20/2003  | 5/19/2004 Passed/agreed to in the Senate, with an amendment  |
|  | HR 1661  | Rangel   | 4/8/2003   | Referred to the Ways & Means Committee   |
| <b>First Time Penalty Waiver</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 188–92.                | Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.   |          |            |  |
|  | Bill Number  | Sponsor  | Date       | Status   |
| Legislative Activity 108th Congress  | HR 1528  | Portman  | 6/20/2003  | 5/19/2004 Passed/agreed to in the Senate, with an amendment  |
|  | HR 1661  | Rangel   | 4/8/2003   | Referred to the Ways & Means Committee   |
| Legislative Activity 107th Congress  | HR 3991  | Houghton | 3/19/2002  | Defeated in the House  |
| <b>Federal Tax Deposit (FTD) Avoidance Penalty</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 222. | Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.   |          |            |  |
|  | Bill Number  | Sponsor  | Date       | Status   |
| Legislative Activity 109th Congress  | HR 3629  | Doggett  | 7/29/2005  | Referred to the Ways & Means Committee   |
|  | HR 3841  | Manzullo | 9/2/2005   | Referred to the Ways & Means Committee   |
|  | S 1321RS   | Santorum | 6/28/2005  | 9/15/2006 The Finance Committee, reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614 |
| Legislative Activity 108th Congress  | HR 1528  | Portman  | 6/20/2003  | 5/19/2004 Passed/agreed to in the Senate with an amendment   |
|  | HR 1661  | Rangel   | 4/8/2003   | Referred to the Ways & Means Committee   |
| Legislative Activity 107th Congress  | HR 586   | Lewis    | 2/13/2001  | 4/18/2002 Passed the House with an amendment; referred to the Senate   |
|  | HR 3991  | Houghton | 3/19/2002  | Defeated in the House  |
| Family Issues  |  |          |            |  |
| <b>Uniform Definition of a Qualifying Child</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 78–100. | Create a uniform definition of “qualifying child” applicable to tax provisions relating to children and family status.   |          |            |  |
| Legislative Activity 108th Congress  | Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).  |          |            |  |
| <b>Means-Tested Public Assistance Benefits</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 76–127.  | Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or “not married” status. |          |            |  |
|  | Bill Number  | Sponsor  | Date       | Status   |
| Legislative Activity 108th Congress  | HR 22  | Houghton | 1/3/2003   | Referred to the Ways & Means Committee   |
| Legislative Activity 107th Congress  | HR 5505  | Houghton | 10/01/2002 | Referred to the Ways & Means Committee   |



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| <b>Credits for the Elderly or the Permanently Disabled</b>                         |   |          |           |  |
| National Taxpayer Advocate 2001 Annual Report to Congress 218–19.                  | Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.  |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status   |
| Legislative Activity 107th Congress  | S 2131  | Bingaman | 4/15/2002 | Referred to the Finance Committee  |
| <b>Electronic Filing Issues</b>  |   |          |           |  |
| <b>Scannable Returns</b>   |   |          |           |  |
| National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96. | Require electronically prepared paper returns to include scannable 2-D code.  |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status   |
| Legislative Activity 113th Congress  | S 2736  | Hatch    | 7/14/2014 | Referred to the Finance Committee  |
| <b>Return Filing and Processing</b>  |   |          |           |  |
| National Taxpayer Advocate 2013 Annual Report to Congress, Volume 2, 68-96.        | Eliminate the March 31st deadline for e-filed information reports. All information reports, whether e-filed or filed on paper, would be due at the end of February.     |          |           |  |
| Legislative Activity 114th Congress  | <b>Pub. L. No. 114-113, Division Q § 201 (2015).</b>  |          |           |  |
| <b>Safe Harbor for De Minimis Errors Returns and Payee Statements</b>              |   |          |           |  |
| National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96. | Safe harbor for <i>de minimis</i> errors on information   |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status   |
| Legislative Activity 114th Congress  | <b>Pub. L. No. 114-113, Division Q § 202 (2015).</b>  |          |           |  |
| Legislative Activity 113th Congress  | S 2736  | Hatch    | 7/14/2014 | Referred to the Finance Committee  |
| <b>Direct Filing Portal</b>  |   |          |           |  |
| National Taxpayer Advocate 2004 Annual Report to Congress 471–77.                  | Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.                                |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status   |
| Legislative Activity 112th Congress  | S 1289  | Carper   | 6/28/2011 | Referred to the Finance Committee  |
| Legislative Activity 110th Congress  | S 1074  | Akaka    | 3/29/2007 | Referred to the Finance Committee  |
|  | HR 5801   | Lampson  | 4/15/2008 | Referred to the Ways & Means Committee   |
| Legislative Activity 109th Congress  | S 1321RS  | Santorum | 6/28/2005 | 9/15/2006 Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336<br>9/15/2006 Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614 |
| <b>Free Electronic Filing For All Taxpayers</b>                                    |   |          |           |  |
| National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96  | Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers. |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status   |
| Legislative Activity 110th Congress  | S 2736  | Hatch    | 7/14/2014 | Referred to the Finance Committee  |

| Office of the Taxpayer Advocate   |   |            |            |   |
|---|---|------------|------------|---|
| <b>Repeal or Fix Statute Suspension Under IRC § 7811(d)</b><br>National Taxpayer Advocate 2015 Annual Report to Congress 316–28.  | Repeal suspension of statute of limitations during pending application for Taxpayer Assistance Order or clarify.  |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 114th Congress   | HR 4912   | Lewis      | 4/12/2016  | Referred to the Ways & Means Committee                      |
| <b>Confidentiality of Taxpayer Communications</b><br>National Taxpayer Advocate 2002 Annual Report to Congress 198–215.   | Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to TAS. |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 108th Congress   | HR 1528   | Portman    | 6/20/2003  | 5/19/2004 Passed/agreed to in the Senate, with an amendment |
|   | HR 1661   | Rangel     | 4/8/2003   | Referred to the Ways & Means Committee                      |
| <b>Access to Independent Legal Counsel</b><br>National Taxpayer Advocate 2002 Annual Report to Congress 198–215.  | Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of <i>amicus</i> briefs.  |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 108th Congress   | HR 1528   | Portman    | 6/20/2003  | Referred to the Senate                                      |
|   | HR 1661   | Rangel     | 4/8/2003   | Referred to the Ways & Means Committee                      |
| <b>Taxpayer Advocate Directive</b><br>National Taxpayer Advocate 2012 Annual Report to Congress 573–602;<br>National Taxpayer Advocate 2002 Annual Report to Congress 419–22. | Amended IRC § 7811 to provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the Internal Revenue Service with respect to any program, proposed program, action, or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large.  |            |            |   |
|   | Bill Number   | Sponsor    | Date       | Status  |
| Legislative Activity 114th Congress   | S 2333  | Cardin     | 11/30/2015 | Referred to the Finance Committee                           |
|   | HR 4128   | Becerra    | 11/30/2015 | Referred to the Ways & Means Committee                      |
|   | S 949   | Cornyn     | 4/15/2015  | Referred to the Finance Committee                           |
|   | HR 1828   | Thornberry | 4/15/2015  | Referred to the Ways & Means Committee                      |
| Legislative Activity 112th Congress   | S 3355  | Bingaman   | 6/28/2012  | Referred to the Finance Committee                           |
|   | HR 6050   | Becerra    | 6/28/2012  | Referred to the Ways & Means Committee                      |
| Legislative Activity 111th Congress   | S 3215  | Bingaman   | 4/15/2010  | Referred to the Finance Committee                           |
|   | HR 5047   | Becerra    | 4/15/2010  | Referred to the Ways & Means Committee                      |
| Exempt Organizations (EO)   |   |            |            |   |
| <b>EO Judicial and Administrative Review</b><br>National Taxpayer Advocate 2014 Annual Report to Congress 573–602, 371–79.  | Amend IRC § 7428 to allow taxpayers seeking exemption as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as those seeking exempt status as IRC § 501(c)(3) organizations.   |            |            |   |
| Legislative Activity 114th Congress   | Pub. L. No. 114-113, Division Q § 406 (2015).   |            |            |   |

|  |  |         |            |  |
|--|--|---------|------------|--|
| <b>Notification to Exempt Organizations</b><br>National Taxpayer Advocate 2011 Annual Report to Congress 444.  | Require the IRS to notify exempt organizations that have not filed an annual notice or return for two consecutive years that the IRS has no record of receiving a return or notice and that the organization's exemption will be revoked if it does not file by the next filing deadline                   |         |            |  |
|  | Bill Number  | Sponsor | Date       | Status   |
| Legislative Activity 114th Congress  | S 3156   | Hatch   | 7/12/2016  | Placed on Senate Legislative Calendar under General Orders   |
| <b>Other Issues</b>  |  |         |            |  |
| <b>Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact</b><br>National Taxpayer Advocate 2008 Annual Report to Congress 419–22. | Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of \$100,000 per individual per year and \$200,000 per entity per year for failure to make special disclosures of a “listed transaction.”   |         |            |  |
|  | Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).   |         |            |  |
| Legislative Activity 111th Congress  | Bill Number  | Sponsor | Date       | Status   |
|  | S 2771   | Baucus  | 11/16/2009 | Referred to the Finance Committee  |
|  | HR 4068  | Lewis   | 11/16/2009 | Referred to the Ways & Means Committee   |
|  | S 2917   | Baucus  | 12/18/2009 | Referred to the Finance Committee  |
| <b>Eliminate Tax Strategy Patents</b><br>National Taxpayer Advocate 2007 Annual Report to Congress 512–24.   | Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.   |         |            |  |
|  | Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).   |         |            |  |
| <b>Disclosure Regarding Suicide Threats</b><br>National Taxpayer Advocate 2001 Annual Report to Congress 227.  | Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury. |         |            |  |
|  | Bill Number  | Sponsor | Date       | Status   |
| Legislative Activity 112th Congress  | HR 1528  | Portman | 6/20/2003  | 5/19/2004 Passed/agreed to in the Senate, with an amendment  |
|  | S 882  | Baucus  | 4/10/2003  | 5/19/2004 S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882 |
|  | HR 1661  | Rangel  | 4/8/2003   | Referred to the Ways & Means Committee   |
| Legislative Activity 107th Congress  | HR 586   | Lewis   | 2/13/2001  | 4/18/2002 Passed the House with an amendment; referred to the Senate                                 |
| <b>Attorney Fees</b><br>National Taxpayer Advocate 2002 Annual Report to Congress 161–71.  | Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees “above the line.” Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.   |         |            |  |
|  | Pub. L. No. 108-357, § 703, 118 Stat. 1418, 1546-48 (2004).  |         |            |  |
| <b>Attainment of Age Definition</b><br>National Taxpayer Advocate 2003 Annual Report to Congress 308–11.   | Amend IRC § 7701 by adding a new subsection as follows: “Attainment of Age. An individual attains the next age on the anniversary of his date of birth.”   |         |            |  |
|  | Bill Number  | Sponsor | Date       | Status   |
| Legislative Activity 108th Congress  | HR 4841  | Burns   | 7/15/2004  | 7/21/2004 Passed the House;<br>7/22/2004 Received in the Senate                                      |

|  |   |          |           |  |
|--|---|----------|-----------|--|
| <b>Home-Based Service Workers (HBSW)</b>   |   |          |           |  |
| National Taxpayer Advocate 2001 Annual Report to Congress 193–201.                     | Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.  |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status                                 |
| Legislative Activity 110th Congress  | HR 5719   | Rangel   | 4/16/2008 | Referred to the Finance Committee      |
| Legislative Activity 107th Congress  | S 2129  | Bingaman | 4/15/2002 | Referred to the Finance Committee      |
| <b>Restrict Access to the Death Master File (DMF)</b>                                  |   |          |           |  |
| National Taxpayer Advocate 2011 Annual Report to Congress 519–23.                      | Restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.   |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status                                 |
| Legislative Activity 113th Congress  | <b>H.J. Res. 59, 113th Cong. § 203 (2013).</b>  |          |           |  |
| Legislative Activity 112th Congress  | S 3432  | Nelson   | 7/25/2012 | Referred to the Finance Committee      |
|  | HR 6205   | Nugent   | 7/26/2012 | Referred to the Ways & Means Committee |
| <b>Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes</b> |   |          |           |  |
| National Taxpayer Advocate 2012 Annual Report to Congress 521.                         | Amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a “State”.   |          |           |  |
|  | Bill Number   | Sponsor  | Date      | Status                                 |
| Legislative Activity 114th Congress  | S 835   | Heitkamp | 3/23/2015 | Referred to the Finance Committee      |
|  | HR 1542   | Kilmer   | 3/23/2015 | Referred to the Ways & Means Committee |
| Legislative Activity 113th Congress  | S 835   | Johnson  | 7/09/2014 | Referred to the Finance Committee      |
|  | HR 1738   | Kilmer   | 6/12/2013 | Referred to the Ways & Means Committee |
| <b>Filing Due Dates of Partnerships and Certain Trusts</b>                             |   |          |           |  |
| National Taxpayer Advocate 2003 Annual Report to Congress 302.                         | Amend Internal Revenue Code section 6072(a) to change the regular filing deadline for partnerships described in Section 6031 and trusts described in Section 6012(a)(4) as follows:<br><ul style="list-style-type: none"> <li>♦ For partnerships and trusts making returns on the basis of a calendar year: Change the regular filing deadline from the 15th day of April following the close of the calendar year to the 15th day of March following the close of the calendar year.</li> <li>♦ For partnerships and trusts making returns on the basis of a fiscal year: Change the regular filing deadline from the 15th day of the fourth month following the close of the fiscal year to the 15th day of the third month following the close of the fiscal year</li> </ul> |          |           |  |
| Legislative Activity 114th Congress  | <b>Pub. L. No. 114-41 § 2006, 129 Stat. 443, 457 (2015).</b>  |          |           |  |
| <b>Foreign Account Reporting</b>   |   |          |           |  |
| National Taxpayer Advocate 2014 Annual Report to Congress 331.                         | Align the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). Change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938 (including extensions).   |          |           |  |
| Legislative Activity 114th Congress (July 31, 2015)                                    | <b>Pub. L. No. 114-41 § 2006, 129 Stat. 443, 458-459 (2015).</b>  |          |           |  |

## Individual Taxpayer Identification Numbers (ITINs)

**Requirements for the Issuance of ITINs**

National Taxpayer Advocate 2008 Annual Report to Congress 126;  
National Taxpayer Advocate 2010 Annual Report to Congress 319.

Administrative recommendation that the IRS should promote the Certified Acceptance Agent program and use other federal agencies to perform acceptance agent duties as contemplated in the Treasury Regulation (e.g., the Postal Service performs a similar service in processing passport applications).

Legislative Activity 114th Congress  
(July 31, 2015)

**Pub. L. No. 114-113, Division Q § 203 (2015).**

**Develop a Process To Verify That Previously Issued ITINs Have Been Used for Tax Administration Purposes**

National Taxpayer Advocate 2008 Annual Report to Congress 126;  
National Taxpayer Advocate 2010 Annual Report to Congress 319.

Administrative recommendation the IRS should develop a process to verify that previously issued ITINs have been used for tax administration purposes and revoke unused ITINs on a regular basis after notifying ITIN holders.

Legislative Activity 114th Congress

**Pub. L. No. 114-113, Division Q § 203 (2015).**

**Whistleblower**

National Taxpayer Advocate 2015 Annual Report to Congress 409–12.

Amend IRC § 7623 to include anti-retaliation protection for tax whistleblowers and impose a penalty on whistleblowers for unauthorized disclosure of tax information.

|                                     | Bill Number | Sponsor | Date      | Status   |
|-------------------------------------|-------------|---------|-----------|--|
| Legislative Activity 114th Congress | S 3156      | Hatch   | 7/12/2016 | Placed on Senate Legislative Calendar under General Orders |

LR  
#1**TAX REFORM: Simplify the Internal Revenue Code Now****PROBLEM**

It has now been more than 30 years since Congress enacted the Tax Reform Act of 1986 to substantially simplify the tax code, and since that time, the code has grown more complex by the year, as evidenced by the fact that Congress has made more than 5,900 changes to the code — an average of more than one a day — just since 2001. The compliance burdens the tax code imposes on taxpayers and the IRS alike are overwhelming, and we urge Congress to act this year to vastly simplify it.

In prior reports, the National Taxpayer Advocate has designated the complexity of the tax code as the most serious problem facing taxpayers and has recommended general principles and specific areas for reform.<sup>1</sup> With an incoming Administration and Congress, we reiterate those recommendations in this report.

Among other things, the tax code:

- Makes compliance difficult, requiring taxpayers to devote excessive time to preparing and filing their returns;
- Requires the significant majority of taxpayers to bear monetary costs to comply, as most taxpayers hire preparers and many other taxpayers purchase tax preparation software;
- Rewards taxpayers who can afford expensive tax advice and discriminates against taxpayers who cannot;
- Undermines trust and confidence in the tax system, as many taxpayers do not understand how their taxes are computed or even what rate of tax they pay;
- Leads to lower levels of tax compliance, as taxpayers make high rates of both inadvertent and deliberate errors, and the complexity of tax returns limits the IRS's ability to detect noncompliance through audits or other means; and
- Requires a large federal agency to administer the tax system, as the IRS must, among other things, publish forms and publications, create computer code for thousands of tax provisions, enforce the law, and respond to more than 100 million telephone calls, ten million letters, and five million visits from taxpayers every year.

In general, tax simplification would require Congress to pare back the number of income exclusions, exemptions, deductions, credits, and preferential tax rates (collectively known as “tax expenditures”). For fiscal year (FY) 2016, the Treasury Department projected that tax expenditures would come to about

<sup>1</sup> See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 3-23 (Most Serious Problem: *The Complexity of the Tax Code*); National Taxpayer Advocate 2010 Annual Report to Congress 3-14 (Most Serious Problem: *The Time for Tax Reform Is Now*); National Taxpayer Advocate 2010 Annual Report to Congress 365-72 (Legislative Recommendation: *Enact Tax Reform Now*); National Taxpayer Advocate 2005 Annual Report to Congress 375-80 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*); *Fundamental Tax Reform: Hearing Before the H. Comm. on Ways and Means*, 112th Cong. 6-38 (2011) (statement of Nina E. Olson, National Taxpayer Advocate), <https://www.gpo.gov/fdsys/pkg/CHRG-112hhrg70869/pdf/CHRG-112hhrg70869.pdf>; *Public Meeting of the President's Advisory Panel on Federal Tax Reform* (Mar. 3, 2005) (statement of Nina E. Olson, National Taxpayer Advocate), <http://govinfo.library.unt.edu/taxreformpanel/meetings/meeting03032005.html>.



\$1.42 trillion.<sup>2</sup> As a point of comparison, total individual income tax revenue was projected to be about \$1.63 trillion.<sup>3</sup>

**FIGURE 2.1.1**

**Tax Expenditures vs. Individual Income Tax Revenue, FY 2016**



This suggests that if Congress were to eliminate all tax expenditures, it could cut individual income tax rates by about 47 percent and still generate about the same amount of revenue.<sup>4</sup>

This is the essence of comprehensive tax simplification. Tax expenditures would be substantially eliminated and the additional revenue would be used to substantially reduce tax rates, leaving the average taxpayer with about the same tax bill he or she has now – but with the ability to compute it much more simply and accurately.

We fully acknowledge that simplifying the tax code requires important policy trade-offs. To cite some well-known examples, Congress historically has allowed married couples and heads-of-households with children to claim larger standard deductions than single taxpayers, thus taxing them less on equivalent incomes. It has allowed a personal exemption for each taxpayer that participates in the filing of a joint return and a dependency exemption for each eligible child, again reflecting a social policy that taxes married couples and larger families less than single taxpayers and smaller families on equivalent incomes. In enacting the Earned Income Tax Credit (EITC), Congress on a bipartisan basis created a social benefits

2 See Office of Tax Analysis, U.S. Department of the Treasury, *Tax Expenditures* (Sept. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2018.pdf>. It should be noted that estimates of “tax expenditures” do not include the amount of tax revenue forgone due to the standard deduction and personal and dependency exemptions, even though those provisions reflect congressional policy decisions embedded in the tax code. If the revenue reductions associated with these provisions were taken into account, the total of tax expenditures estimates would be substantially greater than \$1.42 trillion.

3 See Office of Management and Budget, *Budget of the United States Government, Historical Tables*, Table 2.1, <http://www.whitehouse.gov/omb/budget/Historicals>.

4 We cite this figure solely as a ballpark estimate. On the one hand, if all tax expenditures included in the Treasury Department’s and Joint Committee on Taxation’s estimates were repealed simultaneously, the additional revenue generated would probably be less than the sum total of tax expenditures because of interactive effects. On the other hand, if all tax expenditures were eliminated, the taxable income of many taxpayers would increase, moving some taxpayers into higher marginal tax-rate brackets and thereby increasing their tax liabilities. In addition, as noted above, estimates of “tax expenditures” do not include the amount of tax revenue forgone due to the standard deduction and personal and dependency exemptions, even though those provisions reflect congressional policy decisions embedded in the tax code. These totals are intended solely to paint a general portrait of the magnitude of tax expenditures. See Leonard Burman, Eric Toder & Christopher Geissler, *How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?* Discussion Paper 31, Amer. Soc. Sci. Assoc’n, 3 (Jan. 5, 2008) <http://www.taxpolicycenter.org/publications/how-big-are-total-individual-income-tax-expenditures-and-who-benefits-them/full>; shorter version published in 98 AMER. ECON. REV. 79 (2008) (stating that despite interaction effects, “commentators have added up tax expenditures to make general statements about their magnitude”).

program styled as a work incentive, so that only taxpayers who work are eligible to receive program benefits.<sup>5</sup> And on the business side, Congress has provided incentives for research, among other things. In fact, every provision in the tax code was enacted for a policy reason, and it is not likely Congress will choose to eliminate all tax expenditures, nor do we recommend that it do so.

However, we strongly recommend significant tax simplification, and to accomplish it, we recommend Congress use a “zero-based budgeting” approach. The starting point for discussion would be a tax code without any exclusions or reductions in income or tax. A tax break or IRS-administered social program would be added only if lawmakers decide, on balance, that the public policy benefits of running the provision or program through the tax code outweigh the tax complexity burden that the provision creates for taxpayers and the IRS. At the end of the exercise, tax rates can be set at whatever level is required to raise the amount of revenue that Congress determines is appropriate.

In the event Congress determines comprehensive tax simplification is not feasible at this time, we also recommend below certain areas for limited tax simplification.

### The Tax Code Imposes Onerous Compliance Burdens on Individual Taxpayers and Businesses

A few data points will illustrate the magnitude of the compliance burdens the tax code imposes on individuals and businesses:

- According to a TAS analysis of IRS data, individuals and businesses spend about six billion hours a year complying with the filing requirements of the Internal Revenue Code (IRC).<sup>6</sup> And that figure does not include the millions of additional hours that taxpayers must spend when they are required to respond to IRS notices or audits.

<sup>5</sup> See Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *infra*.

<sup>6</sup> The TAS Research function arrived at this estimate by multiplying the number of copies of each form filed for calendar year 2015 by the average amount of time the IRS estimated it took to complete the form. Except as noted below, tax return counts are calendar year 2015 estimated counts and come from IRS Document 6149, Table 1 – 2015 Update (revised Nov. 2015), <http://www.irs.gov/pub/irs-soi/d6149.pdf>. Information return counts are actual calendar year 2015 counts and come from IRS Document 6961, Table 2 – 2016 Update (revised July 2016), <http://www.irs.gov/pub/irs-soi/d6961.pdf>. Time burden estimates are listed in form instructions or, some cases, on the forms themselves. Additional notes: burden estimates for Form 8962, *Premium Tax Credit (PTC)*, and Form 8965, *Health Coverage Exemption*, are included in the Form 1040 average; data for ACA information returns (Forms 1094-B, 1095-B, 1094-C, and 1095-C) and FATCA Forms 8966 and 8809-EX are currently not available; form counts for Forms 1065 and 1065B are from the Business Return Transaction File Form 1065 and Form 1065B tables on the Compliance Data Warehouse for returns filed during processing year 2015 (Nov. 2016); the time burden estimate for Forms 1120-L/ND/PC/REIT/SF is from the Form 1120-REIT to be conservative, as it had the lowest average of this form series; form counts for Forms 940 and 940A are from the Business Return Transaction File Form 940 and Form 940 Detail (Sch. A) table on the Compliance Data Warehouse for returns filed during processing year 2015 (Nov. 2016); and the form count for Form 8938 is from the Electronic Tax Administration Research and Analysis System (ETARAS) data table on the Compliance Data Warehouse for returns filed during processing year 2015 (Nov. 2016). While the IRS's estimates are the most authoritative available, the amount of time the average taxpayer spends completing a form is difficult to measure with precision. This TAS estimate may be low because it does not take into account all forms and, as noted in the text, it does not include the amount of time taxpayers spend responding to post-filing notices, examinations, or collection actions. Conversely, the TAS estimate may be high because IRS time estimates have not necessarily kept pace fully with technology improvements that allow a wider range of processing activities to be completed via automation.

**FIGURE 2.1.2, Hours Required to Prepare Tax Returns and Information Reporting Documents, Calendar Year 2015**

| Type of Return  | Number of Forms | Time Per Form (in hours) | Total Hours             |
|---|-----------------|--------------------------|-------------------------|
| <b>Tax Returns</b>  |                 |                          |                         |
| Form 1040: U.S. Individual Income Tax Return  | 148,477,500     | 13                       | 1,930,207,500.00        |
| Form 1041: U.S. Income Tax Return for Estates and Trusts  | 3,238,800       | 89.47                    | 289,775,436.00          |
| Form 1041-ES: Estimated Income Tax for Estates and Trusts   | 671,200         | 2.28                     | 1,530,336.00            |
| Form 1065: U.S. Return of Partnership Income  | 3,748,283       | 93.15                    | 349,152,561.45          |
| Form 1065B: U.S. Return of Income for Electing Large Partnerships   | 85              | 153.30                   | 13,030.50               |
| Form 1120S: U.S. Income Tax Return for an S Corporations  | 4,759,100       | 155.38                   | 739,468,958.00          |
| Forms 1120/1120A: U.S. Corporation Income Tax Return  | 1,791,400       | 185.68                   | 332,627,152.00          |
| Form 1066: U.S. Real Estate Mortgage Investment Conduit (REMIC) Income Tax Return   | 39,200          | 53.77                    | 2,107,784.00            |
| Form 1120-C: U.S. Income Tax Return for Cooperative Associations  | 8,900           | 111.85                   | 995,465.00              |
| Form 1120-F: U.S. Income Tax Return of a Foreign Corporation  | 44,200          | 185.45                   | 8,196,890.00            |
| Form 1120-H: U.S. Income Tax Return for Homeowners Associations   | 250,400         | 32.62                    | 8,168,048.00            |
| Forms 1120-L/ND/PC/REIT/SF: U.S. Life Insurance Company Income Tax Return/Return for Nuclear Decommissioning Funds and Certain Related Persons/U.S. Property and Casualty Insurance Company Income Tax Return/U.S. Income Tax Return for Real Estate Investment Trusts/U.S. Income Tax Return for Settlement Funds (Under Section 468B) | 20,500          | 131.75                   | 2,700,875.00            |
| Form 1120-RIC: U.S. Income Tax Return for Regulated Investment Companies  | 16,700          | 116.93                   | 1,952,731.00            |
| Form 706: United States Estate (and Generation - Skipping Transfer) Tax Return  | 36,328          | 7.75                     | 281,542.00              |
| Form 709: United States Gift (and Generation - Skipping Transfer) Tax Return  | 277,500         | 6.15                     | 1,706,625.00            |
| Form 940: Employer's Annual Federal Unemployment (FUTA) Tax Return  | 3,750,349       | 3.87                     | 14,513,850.63           |
| Form 940 Schedule A: Multi-State Employer and Credit Reduction Information  | 1,829,849       | 13.60                    | 24,885,946.40           |
| Form 941: Employer's Quarterly Federal Tax Return   | 24,611,500      | 2.88                     | 70,881,120.00           |
| Form 990: Return of Organization Exempt from Income Tax   | 323,700         | 139.63                   | 45,198,231.00           |
| Form 990-EZ: Short Form Return of Organization Exempt from Income Tax   | 278,100         | 55.65                    | 15,476,265.00           |
| Form 990-PF: Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation  | 103,500         | 203.05                   | 21,015,675.00           |
| Form 990-T: Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))  | 180,700         | 141.80                   | 25,623,260.00           |
| Form 720: Quarterly Federal Excise Tax Return   | 205,200         | 57.52                    | 11,803,104.00           |
| Form 1040X: Amended U.S. Individual Income Tax Return   | 3,623,600       | 10.00                    | 36,236,000.00           |
| Form 8938: Statement of Specified Foreign Financial Assets  | 246,230         | 4.62                     | 1,137,582.60            |
| Form 5227: Split - Interest Trust Information Return  | 106,500         | 148.40                   | 15,804,600.00           |
| Form 943: Employer's Annual Federal Tax Return for Agricultural Employees   | 196,600         | 11.95                    | 2,349,370.00            |
| Form 4720: Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code (Sections 170(f)(10), 664(c)(2), 4911, 4912, 4941, 4942, 4943, 4944, 4945, 4955, 4958, 4959, 4965, 4966, and 4967)  | 2,300           | 113.37                   | 260,751.00              |
| Form 5500-EZ: Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan   | 118,500         | 27.98                    | 3,315,630.00            |
| Form 2290: Heavy Highway Vehicle Use Tax Return   | 750,200         | 42.85                    | 32,146,070.00           |
| Form 8752: Required Payment or Refund Under Section 7519  | 29,200          | 7.85                     | 229,220.00              |
| Form 2553: Election by a Small Business Corporation   | 447,900         | 16.37                    | 7,332,123.00            |
| Form 7004: Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns  | 6,542,900       | 6.77                     | 44,295,433.00           |
| <b>Tax Returns Subtotal</b>   |                 |                          | <b>4,041,389,165.58</b> |

**FIGURE 2.1.2, Hours Required to Prepare Tax Returns and Information Reporting Documents, Calendar Year 2015 (continued)**

| Type of Return   | Number of Forms | Time Per Form (in hours) | Total Hours             |
|--|-----------------|--------------------------|-------------------------|
| <b>Information Returns</b>   |                 |                          |                         |
| Form W-2: Wage and Tax Statement   | 243,550,600     | 0.50                     | 121,775,300.00          |
| Form 1041 K-1: Beneficiary's Share of Income, Deductions, Credits, etc.  | 3,403,736       | 7.75                     | 26,378,954.00           |
| Form 1065 K-1: Partner's Share of Income, Deductions, Credits, etc.  | 29,931,317      | 28.22                    | 844,661,765.74          |
| Form 1120S K-1: Shareholder's Share of Income, Deductions, Credits, etc.   | 7,431,895       | 25.73                    | 191,222,658.35          |
| Form 1096: Annual Summary and Transmittal of U.S. Information Returns  | 5,422,293       | 0.22                     | 1,192,904.46            |
| Form 1098: Mortgage Interest Statement   | 81,132,333      | 0.12                     | 9,735,879.96            |
| Form 1098-C: Contributions of Motor Vehicles, Boats and Airplanes  | 123,011         | 0.30                     | 36,903.30               |
| Form 1098-E: Student Loan Interest Statement   | 21,966,235      | 0.12                     | 2,635,948.20            |
| Form 1098-T: Tuition Statement   | 26,156,848      | 0.22                     | 5,754,506.56            |
| Form 1099-A: Acquisition or Abandonment of Secured Property  | 628,993         | 0.15                     | 94,348.95               |
| Form 1099-B: Proceeds From Broker and Barter Exchange Transactions   | 1,434,809,803   | 0.33                     | 478,269,934.33          |
| Form 1099-C: Cancellation of Debt  | 6,364,769       | 0.22                     | 1,400,249.18            |
| Form 1099-CAP: Changes in Corporate Control and Capital Structure  | 416             | 0.18                     | 76.27                   |
| Form 1099-DIV: Dividends and Distributions   | 87,281,753      | 0.38                     | 33,167,066.14           |
| Form 1099-G: Certain Government Payments   | 77,606,213      | 0.32                     | 24,833,988.16           |
| Form 1099-INT: Interest Income   | 143,367,656     | 0.22                     | 31,062,992.13           |
| Form 1099-K: Payment Card and Third Party Network Transactions   | 9,748,857       | 0.33                     | 3,217,122.81            |
| Form 1099-LTC: Long-Term Care and Accelerated Death Benefits   | 299,563         | 0.22                     | 64,905.32               |
| Form 1099-MISC: Miscellaneous Income   | 92,003,184      | 0.30                     | 27,600,955.20           |
| Form 1099-OID: Original Issue Discount   | 2,074,290       | 0.18                     | 373,372.20              |
| Form 1099-PATR: Taxable Distributions Received from Cooperatives   | 1,820,375       | 0.25                     | 455,093.75              |
| Form 1099-Q: Payments From Qualified Education Programs (Under Sections 529 and 530)                                     | 2,404,454       | 0.18                     | 440,816.57              |
| Form 1099-R: Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. | 92,096,506      | 0.42                     | 38,680,532.52           |
| Form 1099-S: Proceeds From Real Estate Transactions  | 3,285,433       | 0.13                     | 427,106.29              |
| Form 1099-SA: Deductions From an HSA, Archer MSA, or Medicare Advantage MSA  | 8,063,576       | 0.15                     | 1,209,536.40            |
| Form 5498: IRA Contribution Information  | 120,105,028     | 0.40                     | 48,042,011.20           |
| Form 5498-ESA: Coverdell ESA Contribution Information  | 405,844         | 0.12                     | 47,348.47               |
| Form 5498-SA: HSA, Archer MSA, or Medicare Advantage MSA Information   | 10,752,553      | 0.17                     | 1,792,092.17            |
| Form 1042S: Foreign Person's U.S. Source Income Subject to Withholding   | 5,282,421       | 17.50                    | 92,442,367.50           |
| Form W2-G: Certain Gambling Winnings   | 11,415,379      | 0.33                     | 3,767,075.07            |
| <b>Information Returns Subtotal</b>  |                 |                          | <b>1,990,783,811.19</b> |
| <b>Grand Total</b>   |                 |                          | <b>6,032,172,976.77</b> |

- If tax compliance were an industry, it would be one of the largest in the United States. To consume six billion hours, the “tax industry” requires the equivalent of three million full-time workers.<sup>7</sup>
- Compliance costs are huge — both in absolute terms and relative to the amount of tax revenue collected. Based on Bureau of Labor Statistics data on the hourly cost of an employee, TAS estimates that the costs of complying with the individual and corporate income tax requirements for 2015 amounted to \$195 billion — or more than ten percent of aggregate income tax receipts.<sup>8</sup>

FIGURE 2.1.3

## Income Tax Compliance Costs vs. Tax Revenue, FY 2015



- According to a tally compiled by a leading publisher of tax information, there have been almost 5,900 changes to the tax code since 2001, an average of more than one a day.<sup>9</sup>

7 This calculation assumes each employee works 2,000 hours per year (i.e., 50 weeks, with two weeks off for vacation, at 40 hours per week).

8 The IRS and several outside analysts have attempted to quantify the costs of tax compliance. For an overview of some previous studies, see Government Accountability Office (GAO), GAO-05-878, *Tax Policy: Summary of Estimates of the Costs of the Federal Tax System* (Aug. 2005), <http://www.gao.gov/new.items/d05878.pdf>. There is no clearly correct methodology, and the results of these studies vary. All monetize the amount of time that taxpayers and their preparers spend complying with the tax code. TAS estimated the cost of complying with personal and business income tax requirements (and thus excluding the time spent complying with employment, estate and gift, excise, and exempt organization tax requirements) by multiplying the total number of hours spent on income tax compliance (5.80 billion) by the average hourly cost of a civilian employee (\$33.58), as reported by the Bureau of Labor Statistics. See Bureau of Labor Statistics, U.S. Department of Labor, *Employer Costs for Employee Compensation – December 2015*, USDL: 16-0463 (March 16, 2016) (including wages and benefits), [www.bls.gov/news.release/archives/ecec\\_03102016.pdf](http://www.bls.gov/news.release/archives/ecec_03102016.pdf). TAS estimated compliance costs as a percentage of total income tax receipts for 2015 by dividing the income tax compliance cost as computed above (\$195 billion) by total 2015 income tax receipts (\$1.88 trillion). See Office of Management and Budget, Budget of the United States Government, Historical Tables, Table 2-1, <https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/hist02z1.xls>.

9 Unpublished data provided by Wolters Kluwer Tax & Accounting to TAS (Dec. 8, 2016). Wolters Kluwer notes there is some subjectivity in computing these numbers because the counts are tied to how legislation is written. In general, an “Act Finding List” lists every Act section (or portion thereof) in a given Public Law and the corresponding amendment(s) it makes to the Internal Revenue Code (IRC). For example, assume an Act adds three new sections to the IRC. If the Act contains three sections that each adds one Code section, Wolters Kluwer would count three Code changes. But if the Act contains one section that adds a new Part to the IRC and that Part, in turn, contains the same three new Code sections, Wolters Kluwer would count one Code change.

**FIGURE 2.1.4, Internal Revenue Code Changes by Year**

| Year                | Changes      |
|---------------------|--------------|
| 2001                | 409          |
| 2002                | 234          |
| 2003                | 118          |
| 2004                | 833          |
| 2005                | 609          |
| 2006                | 537          |
| 2007                | 243          |
| 2008                | 631          |
| 2009                | 235          |
| 2010                | 592          |
| 2011                | 91           |
| 2012                | 293          |
| 2013                | 2            |
| 2014                | 568          |
| 2015                | 450          |
| 2016                | 22           |
| <b>Total</b>        | <b>5,867</b> |
| <b>Average/Year</b> | <b>367</b>   |

- The tax code has grown so long that it has become challenging even to figure out how long it is. A search of the tax code conducted using the “word count” feature in Microsoft Word turned up nearly four million words.<sup>10</sup>
- Individual taxpayers find return preparation so overwhelming that the majority (54 percent at last count) pay preparers to do it for them.<sup>11</sup> Among unincorporated business taxpayers, the figure rises to about 68 percent.<sup>12</sup> Depending on the complexity of the return and other factors, return preparation fees typically range from several hundred dollars to several thousand dollars, and much more for complex businesses. Roughly an additional 40 percent of individual taxpayers use tax software to help them prepare their returns,<sup>13</sup> with leading software packages typically costing \$50 or more.<sup>14</sup>

10 To determine the number of words in the IRC, TAS downloaded Title 26 of the U.S. Code (i.e., the Internal Revenue Code) from the website of the U.S. House of Representatives, <http://uscode.house.gov>. We copied the file into Microsoft Word, and used the “word count” feature to compute the number of words. The online version of Title 26 we used was current through December 12, 2016. In Word, the document ran 10,928 single-spaced pages. The printed code contains certain information that does not have the effect of law, such as a description of amendments that have been adopted, effective dates, cross references, and captions. The word count feature also counts page numbers, the table of contents, and the like. Therefore, our count somewhat overstates the number of words that are officially considered a part of the tax code, although as a practical matter, a person seeking to determine the law will likely have to read and consider many of these additional words, including effective dates, cross references, and captions. Other attempts to determine the length of the Code may have excluded some or all of these components, but there is no clearly correct methodology to use, and we found no easy way to selectively delete information from a document of this length.

11 IRS Compliance Data Warehouse, *Individual Returns Transaction File* (Tax Year 2014).

12 *Id.*

13 *Id.*

14 See, e.g., Robert Farrington, *Comparing Prices of TurboTax, H&R Block, and TaxAct*, The College Investor (Jan. 6, 2016), <http://thecollegeinvestor.com/15201/comparing-prices-turbotax-hr-block-tax-act>.



- The federal government “spends” more money through the tax code each year than it spends to fund the entire federal government through the appropriations process. In FY 2016, as noted above, the Treasury Department estimated “tax expenditures” amounted to more than \$1.4 trillion.<sup>15</sup> At the same time, discretionary appropriations amounted to less than \$1.2 trillion.<sup>16</sup>

FIGURE 2.1.5



### Complexity Helps Taxpayers Who Can Afford Expensive Tax Advice and Discriminates Against Taxpayers Who Cannot

In general, completion of a tax return requires (i) listing gross income (or gross receipts for a business), (ii) claiming various tax benefits like deductions and credits, and (iii) subtracting the value of the tax benefits from gross income (or gross receipts) to arrive at “taxable income.”

The existing tax code contains more than 200 tax benefits that potentially may be claimed by individuals and businesses.<sup>17</sup> Few, if any, taxpayers are familiar with all these benefits, and most preparers are not familiar with all of them as well. As a result, sophisticated taxpayers (or taxpayers who can afford to

15 For a list and description of tax expenditures, see Office of Tax Analysis, U.S. Department of the Treasury, *Tax Expenditures* (Sept. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2018.pdf>. The Joint Committee on Taxation also publishes estimates of tax expenditures. There are some differences in methodology between the Treasury Department’s methodology and the Joint Committee’s methodology. The Joint Committee’s most recent estimate of tax expenditures for fiscal year (FY) 2016 was more than \$1.3 trillion — also greater than federal appropriations but somewhat less than the Treasury Department’s estimate. See Staff of the Joint Committee on Taxation, JCX-141R-15, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019* (Dec. 2015), <https://www.jct.gov/publications.html?func=startdown&id=4857>.

16 The federal budget consists of discretionary spending for government operations that Congress sets through annual appropriations acts and mandatory spending that is established through eligibility and benefit formulas, such as Social Security and Medicare benefits, as well as interest on the federal debt. For FY 2016, appropriated funds totaled about \$1.17 trillion. See Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2016 to 2026*, Table 1-3 (Aug. 2016), <https://www.cbo.gov/sites/default/files/51118-2016-08-BudgetProjections.xlsx>.

17 The Treasury Department’s report lists 167 tax expenditures but does not include provisions with estimated annual costs of less than \$5 million. See Office of Tax Analysis, U.S. Department of the Treasury, *Tax Expenditures, Table 1* (Sept. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2018.pdf>. The Joint Committee on Taxation’s report lists more than 250 tax expenditures, including provisions that generate *de minimis* revenue losses and provisions whose cost was unavailable. See Staff of the Joint Committee on Taxation, JCX-141R-15, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019*, at 2341 (Joint Comm. Print 2015), <https://www.jct.gov/publications.html?func=startdown&id=4857>. As explained in a prior footnote, the Treasury Department and the Joint Committee on Taxation use methodologies that differ in certain respects, so their estimates are not directly comparable.

hire sophisticated tax advisors) are likely to claim most benefits for which they are eligible, while less sophisticated taxpayers often will miss them. A few examples will illustrate missed benefits:

### *Standard Deduction vs. Itemized Deductions*

Individual taxpayers have a choice between claiming a standard deduction and itemizing their deductions, and may elect whichever one reduces their tax bill the most. Yet taxpayers who would pay less tax by itemizing sometimes fail to do so. Although somewhat dated, the Government Accountability Office (GAO) conducted a study of 1998 tax returns specifically on this point. It found that almost one million taxpayers did not itemize their deductions despite having made payments for mortgage interest and points and for state and local income tax that exceeded the amount of the standard deduction for their filing status. The GAO also imputed charitable contributions, real estate taxes, and personal property taxes and concluded that as many as 2.2 million taxpayers who claimed the standard deduction may have shortchanged themselves by failing to itemize.<sup>18</sup>

### *Telephone Excise Tax Credit*

In 2006, taxpayers were permitted to claim a one-time tax credit for telephone excise taxes that the government had improperly collected.<sup>19</sup> The credit ranged from \$30 to \$60, depending on the number of personal exemptions the taxpayer was entitled to claim on the return.<sup>20</sup> No substantiation was required unless a taxpayer claimed a larger amount, so this credit was essentially “free money.” Yet IRS data show that 28 percent of eligible taxpayers (37 million out of 133 million) did not claim the credit.<sup>21</sup>

### *Paid Preparer Errors*

While most taxpayers pay professionals to prepare their returns for them, using a paid preparer is not a guarantee of accuracy. In a 2006 GAO study, auditors posing as taxpayers made undercover visits to unenrolled tax return preparers and had 19 tax returns prepared under two relatively simple fact patterns.<sup>22</sup> The GAO concluded the preparers made errors on every return. The tax liability the preparers computed ranged from underpaying tax by almost \$2,000 to overpaying tax by more than \$1,500. In two cases, preparers claimed the standard deduction on returns where itemizing deductions would have been more advantageous to the taxpayer. These were simple fact patterns that did not involve high income amounts, so the mistakes were significant in relative terms. With a simpler tax code, instances of overclaims and underclaims resulting from code complexity would decline.

The tax liability of an individual or a business should depend solely on how much is owed under the law — not on the taxpayer’s or preparer’s expertise in the law. A simpler tax code would go a long way toward solving this problem and ensuring that similarly situated taxpayers pay the same tax.

18 See GAO, GAO-02-509, *Tax Deductions: Further Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing* (2002), <http://www.gao.gov/assets/240/234179.pdf>.

19 See IRS Notice 2006-50, 2006-1 C.B. 1141. Unlike the other examples cited in this section that are statutory, the telephone excise tax refunds were authorized by the Department of the Treasury after several circuits of the U.S. Court of Appeals ruled that long-distance telephone services at issue were not subject to taxation.

20 IRS News Release, IR-2006-137, *IRS Announces Standard Amounts for Telephone Tax Refunds* (Aug. 31, 2006).

21 IRS Office of Research, Analysis, and Statistics, Response to TAS Information Request (Dec. 17, 2008). One might assume that tax return preparers would know about the credit. Yet IRS data show that 16 percent of practitioner-prepared returns failed to claim the credit. *Id.*

22 See GAO, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (2006), <http://www.gao.gov/assets/120/113330.pdf>. The GAO repeated its undercover shopping visits study in 2014, and the results were generally similar. See GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* (2014), <http://www.gao.gov/assets/670/662356.pdf>.

## A More Transparent Tax Code — and a Better Understanding of How Tax Dollars Are Spent — Could Improve Tax Morale and Probably Increase Voluntary Tax Compliance As Well

No one wants to feel like a “tax chump” – paying more while suspecting that others are taking advantage of loopholes to pay less. Yet the complexity of the tax code and the sense that other taxpayers are able to take advantage of “loopholes” makes many taxpayers feel as though they are overpaying. In a 2012 taxpayer survey conducted for TAS, 73 percent of respondents said “[t]he wealthy have ways of minimizing their Federal taxes that are not available to the average taxpayer” and only 12 percent said, “everyone pays their fair share of taxes.”<sup>23</sup> Taxpayers who believe they are unfairly paying more than others inevitably will feel more justified in “fudging” to right the perceived wrong. Transparency is a critical feature of a successful tax system and is essential if the system is to build taxpayer confidence and maintain high rates of tax compliance. Simplifying the tax code so tax policy choices and computations are more transparent would help reassure taxpayers that the system is not rigged against them.

In this connection, there is a second element of transparency that we recommend Congress consider. Just as we believe taxpayers will place greater trust in the system if they understand how they are taxed, we believe taxpayers will place greater trust in the system if they understand how their tax dollars are spent. We have recommended that Congress direct the IRS to provide all taxpayers with a “taxpayer receipt” showing this.<sup>24</sup> A “taxpayer receipt” could be a more detailed version of the pie chart currently published by the IRS,<sup>25</sup> but it should be provided directly to each taxpayer in connection with the filing of a tax return.<sup>26</sup> Better public awareness of the connection between taxes and government spending has the potential to improve civic morale, increase tax compliance, and make the national dialogue over looming fiscal policy choices more productive as well.

## The Tax Code Is So Complex That the IRS Has Difficulty Administering It

The IRS employs some 78,000 full-time workers and performs many of its tasks very well.<sup>27</sup> However, it faces daunting challenges in administering the current tax code. This report catalogs many of them. Two key indicators of taxpayer service are the IRS’s ability to answer taxpayer telephone calls and the IRS’s ability to respond to taxpayer correspondence.<sup>28</sup>

23 Russell Research, Inc., *Factors Influencing Compliance: Topline Summary* (May 2012). Russell Research conducted this survey for TAS among a statistically representative sample of sole proprietors.

24 See National Taxpayer Advocate 2010 Annual Report to Congress 368 (Legislative Recommendation: *Enact Tax Reform Now*).

25 IRC § 7523 requires the IRS to include pie-shaped graphs showing the relative sizes of major outlay categories and major income categories in its instructions for Forms 1040, 1040A, and 1040EZ. See IRS Form 1040 Instructions (2016 revision covering Tax Year 2015), at 101.

26 In April 2011, the White House website launched a calculator titled “Your Federal Taxpayer Receipt” that allows taxpayers to enter the actual or estimated amounts of their Social Security, Medicare, and income tax payments and see a breakdown showing how their payments are being applied to major categories of federal spending, including Social Security, Medicare, national defense, health care, job and family security programs, interest on the national debt, Veterans benefits, and education. But it appears the calculator was last updated for 2014. See <https://www.whitehouse.gov/21stcenturygov/tools/tax-receipt> (last visited Dec. 13, 2016). Moreover, while we view the availability of this calculator as a positive development, most taxpayers will not take the time to visit this website. We therefore believe a taxpayer receipt should be provided in connection with the filing of a return.

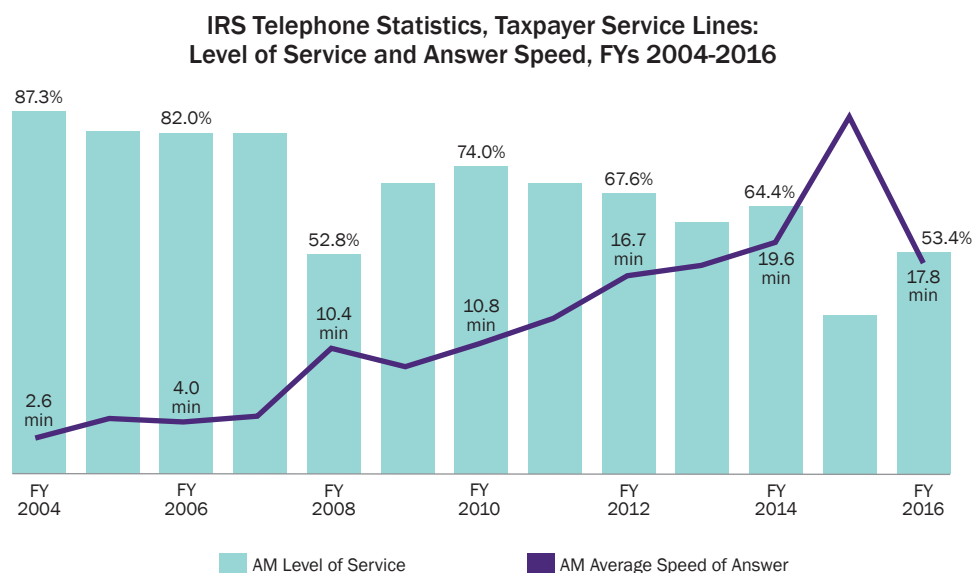
27 The IRS had an average of 77,924 full-time equivalent employees in FY 2016 — almost 17,000 fewer employees than in FY 2011, a reduction of 18 percent. FY 2016 data provided by IRS Chief Financial Officer, Corporate Budget. FY 2011 data reported in IRS Data Book, 2011, Table 30, <http://www.irs.gov/pub/irs-soi/11databk.pdf>.

28 For a more detailed description of IRS workload and how well the IRS is assisting taxpayers and protecting taxpayer rights, see *Taxpayer Rights Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights*, just after the Preface to this report, *supra*.

### Telephone Calls

Despite the fact that more than 90 percent of individual taxpayers rely on preparers or tax software packages, the IRS has received more than 100 million calls in every year since 2008.<sup>29</sup> That is a staggering volume of calls, and not surprisingly, the IRS has trouble answering them. In fact, the problem is growing worse. The IRS reached a high-water mark in providing taxpayer service in FY 2004. Comparing FY 2004 with FY 2016, the number of calls the IRS received from taxpayers on its Accounts Management telephone lines increased from 71 million to 104 million, yet the number of calls answered by telephone assistants declined from 36 million to 26 million.<sup>30</sup> The IRS has increased its ability to handle taxpayer calls using automation, but even so, the percentage of calls from taxpayers seeking to speak with a telephone assistant that the IRS answered dropped from 87 percent to 53 percent over the period.<sup>31</sup> And among the callers who got through, the average time spent waiting on hold increased from just over 2.5 minutes in FY 2004 to nearly 18 minutes in FY 2016.<sup>32</sup>

**FIGURE 2.1.6**



### Taxpayer Correspondence

Over the same FY 2004 through FY 2016 period, the IRS's ability to timely process taxpayer correspondence also declined. In most years from FY 2004 through FY 2012, the IRS received about ten million letters from taxpayers responding to IRS adjustment notices.<sup>33</sup> Because of declining resources, the

29 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2008 through FY 2016).

30 Compare IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016) with IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2004). The Accounts Management telephone lines (previously known as the Customer Account Services telephone lines) receive the significant majority of taxpayer calls. However, taxpayer calls to compliance phone lines and certain other categories of calls are excluded from this total.

31 *Id.*

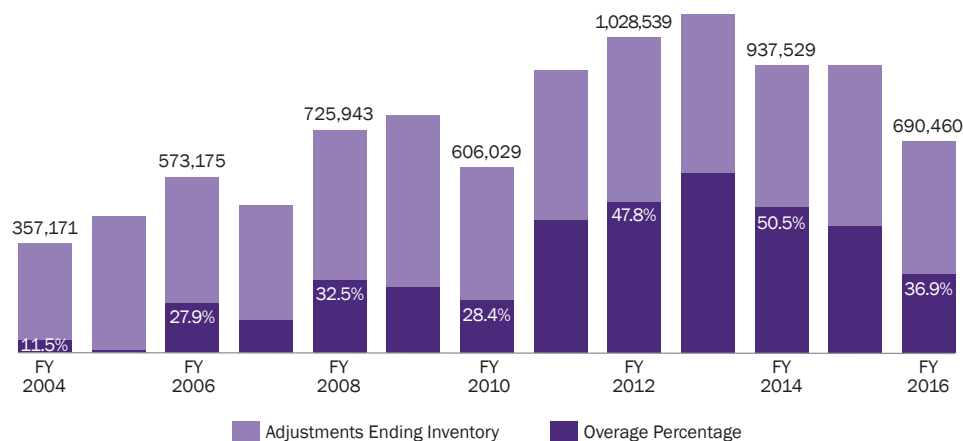
32 *Id.*

33 See, e.g., IRS, Joint Operations Center, *CAS Accounts Management Paper Inventory Reports* (July-September Fiscal Year Comparison for each fiscal year 2004 through 2012).

IRS has initiated fewer adjustments over the last few years. In FY 2016, it received only about 7.8 million letters, yet compared with FY 2004, the backlog of taxpayer correspondence in the tax adjustments inventory increased by 93 percent (from 357,151 to 690,460 pieces), and the percentage of taxpayer correspondence classified as “overage” jumped by 221 percent (from 11.5 percent to 36.9 percent).<sup>34</sup>

**FIGURE 2.1.7**

**IRS Adjustments Correspondence Inventory and Overaged Processing Statistics  
End of Fiscal Years 2004-2016**



As discussed throughout this report, the IRS often struggles to enforce the tax laws and often burdens taxpayers unnecessarily in attempting to do so.

Simply put, tax code complexity strains the IRS’s ability to serve taxpayers, while a simpler code would make the job of the tax administrator much easier — something that would benefit taxpayers and the government alike.

### Tax Simplification Requires Difficult Policy Trade-Offs

In theory, almost everyone supports comprehensive tax simplification. But there is a reason Congress has not simplified the tax code since 1986. The vast majority of tax expenditures in the code benefit the vast majority of U.S. taxpayers, and it is difficult to take benefits away.

As a preliminary note, we use the term “tax expenditure” in this discussion rather than “tax loophole” because, in our view, the term “loophole” has taken on a meaning that distorts discussion. In general, taxpayers and policymakers use the term “loophole” to describe tax expenditures they do not agree with (or do not benefit from) and use terms like “incentives” to describe tax expenditures they like. To promote a constructive dialogue, we should keep in mind that every provision in the tax code had enough support to pass the House and Senate and be signed into law by the President. While some provisions benefit broader taxpayer segments than others, every tax break has a constituency. One taxpayer’s

<sup>34</sup> Compare IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Oct. 1, 2016) with IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2004). The Weekly Enterprise Adjustments Inventory Reports cover a period ending on a Saturday. For each year, we use data from the period ending on the Saturday closest to Sept. 30 (the end of the fiscal year), as reported on the IRS system.

loophole may be another taxpayer's lifeline, and vice versa. The significant majority of tax expenditures benefit the masses.

For FY 2016, as described above, the Treasury Department has estimated that total income tax expenditures will come to about \$1.42 trillion. The following tax expenditures account for almost 80 percent of this total:<sup>35</sup>

**FIGURE 2.1.8, Major Federal Tax Expenditures, FY 2016**

| Major Federal Tax Expenditures, FY 2016   | Dollars         |
|---|-----------------|
| Exclusion of Employer Contributions for Medical Insurance Premiums and Medical Care             | \$210.2 billion |
| Exclusion for Retirement Plan Contributions and Earnings  | \$177.9 billion |
| Reduced Rates of Tax on Long-Term Capital Gains and Dividends                                   | \$137.5 billion |
| Exclusion of Net Imputed Rental Income  | \$105.6 billion |
| Deferral of Income From Controlled Foreign Corporations   | \$102.1 billion |
| Mortgage Interest Deduction on Owner-Occupied Housing   | \$61.2 billion  |
| Deduction for Nonbusiness State and Local Taxes (Except Property Taxes on Owner-Occupied Homes) | \$56.2 billion  |
| Step-Up in Basis of Capital Gains at Death  | \$50.0 billion  |
| Exclusion of Social Security and Veterans' Benefits   | \$44.9 billion  |
| Accelerated Depreciation of Machinery and Equipment   | \$44.6 billion  |
| Deduction for Charitable Contributions  | \$44.1 billion  |
| Exclusion of Capital Gains on Home Sales  | \$43.3 billion  |
| Deduction for State and Local Property Taxes on Owner-Occupied Homes                            | \$34.5 billion  |

Other popular benefits include college education tax incentives, such as the exclusion for distributions from Section 529 education savings plans; income exclusions for armed forces personnel; the deduction for medical expenses; child and dependent care credits; tax-favored employee benefits; and the deduction for contributions to Flexible Spending Accounts (both medical and dependent care).

As this list makes clear, most tax expenditures are designed to advance policy goals. For example, the employer exclusion for medical insurance premiums and medical care is designed to encourage employers to provide health insurance coverage for their employees. The tax breaks for retirement plan contributions and earnings, such as through Section 401(k) plans and Individual Retirement Accounts (IRAs), are designed to encourage retirement savings. The deduction for charitable contributions is designed to encourage greater financial support for nonprofit organizations. The deduction for mortgage

<sup>35</sup> See Office of Tax Analysis, U.S. Department of the Treasury, *Tax Expenditures* (Sept. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2018.pdf>. The Joint Committee on Taxation also makes estimates of tax expenditures, and for FY 2016, it projected total tax expenditures of \$1.33 trillion. See Staff of the Joint Committee on Taxation, JCX-141R-15, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019* (Joint Comm. Print 2015), <https://www.jct.gov/publications.html?func=startdown&id=4857>. In the table that follows, "Exclusion for Retirement Plan Contributions and Earnings" represents the sum of exclusions from income for Section 401(k)-type plans (\$61.8 billion), employer plans (\$70.4 billion), Individual Retirement Accounts (\$16.4 billion), and self-employed plans (sometimes known as "Keogh" plans) (\$28.1 billion), and the low and moderate income savers credit (\$1.3 billion); "Reduced Rates of Tax on Long-Term Capital Gains and Dividends" represents the sum of the reduced rates of tax on capital gains (\$109.5 billion) and the reduced rates of tax on qualified dividends (\$28.0 billion); and "Exclusion of Social Security and Veterans' Benefits" represents the sum of exclusions from income of Social Security benefits (\$36.1 billion) and Veterans' benefits (\$8.8 billion).



interest is designed to encourage home ownership. The elimination of these benefits could have undesirable effects — less health insurance, less retirement savings, smaller charitable contributions, and less home ownership.

From time to time, we read about tax breaks in the code that, at least at first blush, may seem unnecessary or wasteful. But they may serve important policy objectives upon closer review, and in any event, repealing a few isolated tax breaks will have little impact on the big picture. To substantially simplify the tax code, there is no way around eliminating many of the tax expenditures described above.

## RECOMMENDATIONS

### 1. From a Tax Administrative Perspective, Comprehensive Tax Simplification Is the Best Answer

Despite these challenges, the National Taxpayer Advocate strongly supports comprehensive tax simplification. We believe that taxpayers will support tax reform by wide margins if they better understand the trade-offs involved and can be part of an informed dialogue. If tax reform is enacted on a revenue-neutral basis, the average taxpayer's bill will not go up, and taxpayers will be much happier to have a simpler and more transparent system. They will understand how much tax they are paying, they will understand how their tax is computed, and many will save time and money because they no longer will have to pay fees to have their returns prepared.

A simple example illustrates why. Assume a taxpayer earns \$60,000 and Congress determines he should pay federal income tax of \$9,000. At the extremes, there are two possible approaches to arrive at that tax amount. One is to impose a flat tax on his entire \$60,000 income at a rate of 15 percent. A second approach is to make available a menu of tax deductions, credits, and other benefits such that, if the taxpayer knows about all of them and properly claims them, his taxable income will fall to about \$30,000 and will then be taxed at a rate of 30 percent. Both approaches yield the same tax. The first is straightforward and can be computed without detailed knowledge of the tax law or the need to seek assistance from a preparer, while the second approach requires the taxpayer or preparer to know about, and claim, all available tax benefits or end up overpaying.

As discussed above, a pure flat tax is probably unrealistic because, for example, there is a longstanding bipartisan consensus to tax married couples and families less than single workers, to provide tax incentives to encourage home ownership and charitable giving, to provide social welfare via the EITC as a way of making benefits contingent on work, and for businesses, to encourage research activities.

However, a substantially flatter tax would be simpler for taxpayers, would reduce the “tax industry” substantially, and would probably lead to a reduction in the size of the IRS as well, as taxpayers would require less guidance in return preparation and audits would be more straightforward.

To build public support for tax reform, policymakers must first lay the necessary groundwork. Whenever proposals to reduce tax expenditures are made, affected groups and industries typically mobilize quickly to oppose them. It is therefore important that the taxpaying public understand tax reform requires trade-offs between tax rates and tax breaks. An uninformed taxpayer who hears he may lose a tax break will instinctively want to keep it to prevent his tax bill from rising. An informed taxpayer who understands her tax bill will remain the same because tax rates will be lowered will have a very different reaction. The Tax Reform Act of 1986 was the last major revision of the tax code that followed this model, and despite

considerable initial concerns, taxpayers and Members of Congress came around.<sup>36</sup> On the final votes, the Act was supported by significant bipartisan majorities in both the House and the Senate.<sup>37</sup>

Reforming the tax code requires consideration and balancing of several public goals, including fairness and economic efficiency. The National Taxpayer Advocate does not take a position on these broad policy issues. But viewing the tax code strictly from the perspective of minimizing taxpayer burden, there is no doubt: Simpler is better!

## 2. Congress Should Utilize a “Zero-Based Budgeting” Approach and Apply a Set of Core Principles in Approaching Tax Reform

Because it is highly unlikely Congress will eliminate all tax expenditures, it is important to establish a process for determining which tax expenditures to retain and which to repeal.

We offer two suggestions. First, we recommend that Congress approach tax reform in a manner similar to zero-based budgeting. Under that approach, the starting point would be a tax code without any exclusions or reductions in income or tax. As discussions proceed, tax breaks and IRS-administered social programs would be added only if lawmakers decide on balance that the public policy benefits of running the provision or program through the tax code outweigh the tax complexity challenges that doing so creates for taxpayers and the IRS. Factors to consider in making this assessment include whether the government continues to place a priority on encouraging the activity for which the tax incentive is provided, whether the incentive is accomplishing its intended purpose, and whether a tax expenditure is more effective than a direct expenditure or another approach for achieving that purpose.<sup>38</sup>

In addition to suggesting a zero-based budgeting approach to tax reform, we believe the protection of taxpayer rights and minimization of taxpayer burden should be emphasized, along with the IRS’s ability to administer the law. Toward those ends, we have suggested six core principles that should help guide the development of tax reform legislation:

1. The tax system should not “entrap” taxpayers.
2. The tax laws should be simple enough so that most taxpayers can prepare their own returns without professional help, simple enough so that taxpayers can compute their tax liabilities on a single form, and simple enough so that IRS telephone assistants can fully and accurately answer taxpayers’ questions.
3. The tax laws should anticipate the largest areas of noncompliance and minimize the opportunities for such noncompliance.

<sup>36</sup> Pub. L. No. 99-514, 100 Stat. 2085 (1986).

<sup>37</sup> The vote to approve the conference report was 292-136 in the House and 74-23 in the Senate. See Staff of the Joint Committee on Taxation, JCS-10-87, *General Explanation of the Tax Reform Act of 1986* at 4 (May 1987), <http://www.jct.gov/jcs-10-87.pdf>.

<sup>38</sup> When Congress wishes to spend money, it may do so in either of two ways. It can make expenditures directly via cash outlays, or it can make expenditures by providing tax breaks through the tax code. As a practical matter, a tax expenditure has the same impact as a government spending program. To illustrate, assume that an individual facing a 25 percent tax rate pays \$10,000 in mortgage interest and that the government wants to provide a subsidy for home ownership. It could accomplish this objective in two ways: (1) it could allow the taxpayer to deduct the \$10,000 of mortgage interest from his gross income, which would produce a tax reduction of \$2,500, or (2) it could make a direct payment of \$2,500 to the taxpayer in lieu of the tax deduction. The taxpayer ends up in the same economic position either way. For a detailed discussion of tax expenditures, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-119 (*Evaluate the Administration of Tax Expenditures*). In addition, the National Taxpayer Advocate has previously discussed design elements that should be considered when running social benefit programs through the tax code. See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (*Running Social Programs through the Tax System*).

4. The tax laws should provide some choices, but not too many.
5. Where the tax laws provide for refundable credits, they should be designed in a way that the IRS can effectively administer.
6. The tax system should incorporate a periodic review of the tax code — in short, a sanity check.<sup>39</sup>

### 3. Prior National Taxpayer Advocate Recommendations to Simplify Portions of the Tax Code Should Be Considered

Over the past 15 years, the National Taxpayer Advocate has made numerous proposals to simplify various sections or areas of the tax code. While we hope comprehensive simplification is enacted, we offer this list of proposals in the event Congress decides to take a more limited approach to tax reform.

#### *Repeal the Alternative Minimum Tax (AMT) for Individuals*<sup>40</sup>

Few people think of having children or living in a high-tax state as a tax-avoidance maneuver, but under the unique logic of the AMT, that is essentially how those actions are treated. The AMT effectively requires taxpayers to compute their taxes twice — once under the regular tax rules and again under the AMT rules — and then to pay the higher of the two amounts. The regular rules allow taxpayers to claim tax deductions for each dependent (recognizing the costs of maintaining a household and raising a family) and for taxes paid to state and local governments (reducing “double taxation” at the federal and state levels). The AMT rules disallow those deductions. The AMT computations are also extremely burdensome. The National Taxpayer Advocate has repeatedly recommended that the AMT be repealed. Moreover, we note that if tax expenditures are substantially reduced, the AMT would be rendered largely irrelevant.<sup>41</sup>

#### *Consolidate the Family Status Provisions*

Notwithstanding the improvements brought about by enactment of a Uniform Definition of a Child in 2004,<sup>42</sup> the tax code’s family status provisions continue to ensnare taxpayers and make tax administration difficult simply because of the number of such provisions and their structural interaction. These provisions include filing status, personal and dependency exemptions, the child tax credit, the earned income tax credit, the child and dependent care credit, and the separated spouse rule under IRC § 7703(b). Many of the eligibility requirements — such as support or maintenance costs of the

39 The National Taxpayer Advocate previously articulated these principles in a presentation to the President’s Advisory Panel on Federal Tax Reform. See Public Meeting of the President’s Advisory Panel on Federal Tax Reform (Mar. 3, 2005) (statement of Nina E. Olson, National Taxpayer Advocate), [http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/olson\\_03032005.ppt](http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/olson_03032005.ppt). For more detail, see National Taxpayer Advocate 2005 Annual Report to Congress 375-380 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*).

40 See IRC §§ 55-59.

41 Since 2001, the National Taxpayer Advocate has repeatedly identified the AMT as a serious problem for taxpayers and has recommended its repeal in her reports and in congressional testimony. See National Taxpayer Advocate 2013 Annual Report to Congress 292-301 (Legislative Recommendation: *Repeal the Alternative Minimum Tax*); National Taxpayer Advocate 2008 Annual Report to Congress 356-62 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2006 Annual Report to Congress 3-5 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2004 Annual Report to Congress 383-85 (Legislative Recommendation: *Alternative Minimum Tax*); National Taxpayer Advocate 2003 Annual Report to Congress 5-19 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2001 Annual Report to Congress 166-77 (Legislative Recommendation: *Alternative Minimum Tax for Individuals*); see also *Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means* (March 7, 2007) (statement of Nina E. Olson, National Taxpayer Advocate); *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance* (May 23, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).

42 Pub. L. No. 108-311, §§ 201-208, 118 Stat. 1166, 1169-78 (2004).

home — are difficult for the IRS to verify without conducting audits into taxpayers' personal and private lives. The National Taxpayer Advocate has recommended that, as part of a comprehensive reform of the tax code's tax treatment of families, Congress consolidate the numerous existing family status-related provisions into two categories: (1) a Family Credit and (2) a Worker Credit. The refundable Family Credit would reflect the costs of maintaining a household and raising a family, while the refundable Worker Credit would provide an incentive and subsidy for low income individuals to work. She reiterates and expands upon her prior recommendation in this Report.<sup>43</sup>

### *Improve Other Provisions Relating to Taxation of the Family Unit*

The tax code currently imposes “joint and several liability” on married persons who file a joint federal income tax return.<sup>44</sup> This concept dates back to the early years of the income tax when a husband was typically the sole wage earner for the family unit. Today, husbands and wives often have separate assets and incomes that they do not equally control. Recognizing that it is inequitable to hold one spouse liable for tax on the other spouse's income, at least in cases where he or she does not know about the income of the other spouse and does not significantly benefit from it, Congress has enacted relief rules.<sup>45</sup> However, these relief rules are complex, do not always produce the right result, and impose a large burden on the “innocent spouse” to prove his or her case. The National Taxpayer Advocate has recommended several steps to improve equity and simplify the rules, including eliminating joint and several liability for joint filers.<sup>46</sup>

The “kiddie tax” rules are another family-related area of taxation that create significant burden for some taxpayers. The tax code currently taxes a minor child's unearned income above a certain threshold at the parent's tax rate.<sup>47</sup> The parent must decide whether to file a separate return for the child or include the child's income on the parent's own return. The calculations required to determine which option is preferable in a particular case are complex. Moreover, if the child's parents are separated, additional complications arise. If a custodial parent has been designated, the child's income must be included on that parent's return. If no custodial parent has been designated, the law requires the tax to be computed by reference to the return of the parent with the greater taxable income. During a divorce proceeding, however, spouses sometimes conceal their assets or income from the other spouse, making compliance with these rules impractical. To reduce the compliance burden these rules impose while retaining their purpose, the National Taxpayer Advocate has recommended that the unearned income of minor children above a specified threshold be taxed at a higher rate and that the link between the computation of the child's tax liability and the parent's tax return be severed.<sup>48</sup>

43 See Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit (EITC) and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *infra*; National Taxpayer Advocate 2012 Annual Report to Congress 508-12 (Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children*) and 513-20 (Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to Be Considered “Not Married”*). See also National Taxpayer Advocate 2008 Annual Report to Congress 363-69 (Legislative Recommendation: *Simplify the Family Status Provisions*); National Taxpayer Advocate 2005 Annual Report to Congress 397-406 (Legislative Recommendation: *Tax Reform for Families: A Common Sense Approach*).

44 IRC § 6013(d)(3).

45 IRC §§ 66 & 6015.

46 See National Taxpayer Advocate 2005 Annual Report to Congress 407-32 (Legislative Recommendation: *Another Marriage Penalty: Taxing the Wrong Spouse*); see also National Taxpayer Advocate 2001 Annual Report to Congress 128-65 (Legislative Recommendation: *Joint and Several Liability*).

47 IRC § 1(g).

48 See National Taxpayer Advocate 2002 Annual Report to Congress 231-42 (Legislative Recommendation: *Children's Income*).

### *Consolidate Education Savings Tax Incentives*

The tax code contains at least 12 separate incentives to encourage taxpayers to save for and spend on education.<sup>49</sup> The eligibility requirements, definitions of common terms, income-level thresholds, phase-out ranges, and inflation adjustments vary from provision to provision. The point of a tax incentive, almost by definition, is to encourage certain types of economic behavior. However, taxpayers will only respond to incentives if they know they exist and understand them. Few, if any, taxpayers are aware of each of the education tax incentives and familiar enough with the particulars to make wise choices. The National Taxpayer Advocate has recommended that Congress consolidate incentives and harmonize definitions and other terms to the extent possible.<sup>50</sup>

### *Consolidate Retirement Savings Tax Incentives*

The tax code contains at least 15 separate incentives to encourage taxpayers to save for retirement.<sup>51</sup> These incentives are subject to different sets of rules governing eligibility, contribution limits, taxation of contributions and distributions, withdrawals, availability of loans, and portability. Similar to education savings incentives, the large number of retirement savings options and the lack of common definitions and terms can prevent taxpayers from making wise choices or understanding how each incentive works. The National Taxpayer Advocate has recommended that Congress consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement savings option for self-employed taxpayers, one for plans offered by small businesses, and one suitable for plans offered by large businesses and governmental entities (eliminating types of plans that can be used solely by governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.<sup>52</sup>

### *Simplify Worker Classification Determinations to Minimize Employee-Versus-Independent Contractor Disputes*

The complexity and ambiguities in the existing worker classification rules create uncertainty for businesses and workers and lead to noncompliance. In general, businesses are required to pay and withhold employment tax, withhold income tax, and provide benefits only with respect to employees. Consequently, businesses have an incentive to classify workers as independent contractors to reduce their costs. Some workers seeking to avoid their tax obligations may also prefer to be classified as contractors if the business does not withhold taxes or report the payments to the IRS. On the other hand, workers classified as employees generally qualify for benefits that contractors do not.

49 See IRS Pub. 970, *Tax Benefits for Education* 3 (2015).

50 See National Taxpayer Advocate 2008 Annual Report to Congress 370-72 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 403-22 (Legislative Recommendation: *Simplification of Provisions to Encourage Education*).

51 See IRS, *Types of Retirement Plans*, <https://www.irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans-1> (last visited Dec. 12, 2016).

52 See National Taxpayer Advocate 2008 Annual Report to Congress 373-74 (Legislative Recommendation: *Simplify and Streamline Retirement Savings Tax Incentives*); National Taxpayer Advocate 2004 Annual Report to Congress 423-32 (Legislative Recommendation: *Simplification of Provisions to Encourage Retirement Savings*).

Whether a worker should be classified as an employee or an independent contractor depends on a variety of factors that reflect the nature of the relationship between the worker and the business.<sup>53</sup> The National Taxpayer Advocate has recommended that Congress:

- (1) Replace § 530 of the Revenue Act of 1978<sup>54</sup> with a provision applicable to both employment and income taxes, and require that the IRS consult with affected industries and report back to the tax-writing committees on the findings of its consultations, with the ultimate goal that the Secretary issue guidance based on these findings, including guidance with specific industry focus;<sup>55</sup>
- (2) Direct the IRS to develop an electronic tool to determine worker classifications that employers would be entitled to use and rely upon, absent misrepresentation;
- (3) Allow both employers and employees to request classification determinations and seek recourse in the United States Tax Court; and
- (4) Direct the IRS to conduct outreach and education campaigns to increase awareness of the rules as well as the consequences associated with worker classification.<sup>56</sup>

### *Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets*

The tax code contains at least 71 provisions that are scheduled to expire between 2016 and 2025.<sup>57</sup> Tax benefits have increasingly been enacted for a limited number of years to reduce their cost for budget-scoring purposes and are then frequently “extended,” often after they have expired and on a retroactive basis. Thus, tax sunsets make it difficult for both the government and taxpayers to plan, especially when it is uncertain whether Congress will extend a provision that is set to expire. The complexity and uncertainty caused by sunsets make it more difficult for taxpayers to estimate liabilities and pay the correct amount of estimated taxes, complicate tax administration for the IRS, reduce the effectiveness of tax incentives, and possibly reduce tax compliance. The National Taxpayer Advocate has suggested several ways for Congress to reduce or eliminate the procedural incentives to enact temporary tax provisions.<sup>58</sup>

### *Eliminate (or Simplify) Phase-Outs*

Roughly half of all individual income tax returns filed each year are affected by the gradual phase-out of certain tax benefits as a taxpayer’s income increases.<sup>59</sup> These include personal and dependency exemptions and itemized deductions. There are legitimate policy reasons for using phase-outs in certain circumstances. Like tax sunsets, however, phase-outs are largely used to reduce the cost of tax provisions for budget-scoring purposes. Moreover, phase-outs are burdensome for taxpayers, reduce the effectiveness

53 See IRS Pub. 1779, *Independent Contractor or Employee* (2012).

54 Pub. L. No. 95-600, § 530, 92 Stat. 2763, 2885 (1978).

55 The National Taxpayer Advocate’s initial recommendation was simply to require that the Secretary issue guidance. Based on subsequent discussions with small business groups, the National Taxpayer Advocate revised the recommendation to suggest that Congress first direct the IRS to hold a series of consultations with affected industries and report back to the tax-writing committees on its findings.

56 See National Taxpayer Advocate 2008 Annual Report to Congress 375-90 (Legislative Recommendation: *Worker Classification*).

57 See Joint Committee on Taxation, JCX-1-16, *List of Expiring Federal Tax Provisions 2016-2025* (2016), <https://www.jct.gov/publications.html?func=startdown&id=4862>.

58 See National Taxpayer Advocate 2008 Annual Report to Congress 397-409 (Legislative Recommendation: *Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets*).

59 For Tax Year 2006, about 70 million out of a total of about 138 million filed returns were affected by income-based phase-outs. IRS Compliance Data Warehouse, *Individual Returns Transaction File* (Tax Year 2006). We have not subsequently re-computed the number of returns affected by phase-outs, but we are not aware of any changes in law that would significantly affect the proportion of affected returns.



of tax incentives, and make it more difficult for taxpayers to estimate their tax liabilities and pay the correct amount of withholding or estimated taxes, possibly reducing tax compliance. Phase-outs also create marginal “rate bubbles” — income ranges within which an additional dollar of income earned by a relatively low income taxpayer is taxed at a higher rate than an additional dollar of income earned by a relatively high income taxpayer. Because Congress could achieve a similar distribution of the tax burden based on income level by adjusting marginal rates, phase-outs introduce unnecessary complexity to the Code. The National Taxpayer Advocate has recommended that Congress repeal phase-outs or at least reassess them individually to ensure they are necessary to accomplish their intended objective.<sup>60</sup>

### *Streamline the Penalty Regime*

The number of civil tax penalties has increased from about 14 in 1955 to more than 170 today.<sup>61</sup> The last comprehensive reform of the tax code’s penalty provisions was enacted in 1989, after careful study by Congress, the IRS, and others. Since then, legislative and administrative changes to the penalty regime have proceeded piecemeal, without the kind of careful analysis conducted in 1989. The National Taxpayer Advocate has recommended that Congress direct the IRS to (1) collect and analyze more detailed penalty data on a regular basis and (2) conduct an empirical study to quantify the effect of each penalty on voluntary compliance. Congress should appropriate additional funds for this research, as necessary. In the meantime, based on penalty reform principles identified in 1989, the National Taxpayer Advocate has recommended 11 steps that could be taken immediately.<sup>62</sup>

## CONCLUSION

For the reasons described above, we believe that comprehensive tax simplification should be made a priority. A simpler, more transparent tax code will substantially reduce the estimated six billion hours and \$195 billion that taxpayers spend on income tax return preparation; reduce the disparity in tax liabilities between sophisticated or well advised taxpayers and other taxpayers; enable taxpayers to understand how their tax liabilities are computed and prepare their own returns; improve taxpayer morale and tax compliance, including the level of connection that taxpayers feel with the government; and enable the IRS to administer the tax system more effectively and better meet taxpayer needs.

Based on all the comments we receive every year in the Taxpayer Advocate Service and our experience in handling hundreds of thousands of taxpayer cases a year, we believe that lowering rates in exchange for broadening the tax base would be an excellent bargain for U.S. taxpayers.

60 See National Taxpayer Advocate 2008 Annual Report to Congress 410-13 (Legislative Recommendation: *Eliminate (or Simplify) Phase-outs*).

61 IRM 20.1.1.1.1, *Background* (Nov. 25, 2011) (stating that there were 14 civil penalties in 1955); IRS response to TAS information request (July 10, 2014) (stating that the Office of Servicewide Penalties is charged with “administering more than 170 different civil penalties”).

62 See National Taxpayer Advocate 2008 Annual Report to Congress 414-18 (Legislative Recommendation: *Reforming the Penalty Regime*), and vol. 2, at 1-45 (*Research Study: A Framework for Reforming the Penalty Regime*).

LR  
#2**TAX REFORM: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

A taxpayer's "family status" is central to the calculation of his or her taxable income and computation of tax. Despite several legislative improvements<sup>2</sup> and recommendations by the National Taxpayer Advocate and others,<sup>3</sup> this fundamental component of taxation remains one of the most complex facing each and every taxpayer. The Family Status provisions include:

- Filing status (*i.e.*, single, married filing jointly, married filing separately, and head of household);<sup>4</sup>
- Personal and dependency exemptions;<sup>5</sup>
- Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC);<sup>6</sup>
- Earned Income Tax Credit (EITC);<sup>7</sup>

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Congress adopted a Uniform Definition of a Child (UDOC) in the Working Families Tax Relief Act of 2004, effective for tax years beginning after December 31, 2004. Pub. L. No. 108-311, §§ 201, 208, 118 Stat. 1166, 1169, 1178 (2004). Congress made further revisions to UDOC in Pub. L. No. 109-135, § 404(a), 119 Stat. 2577, 2632 (2005) and Pub. L. No. 110-351, § 501, 122 Stat. 3949, 3979 (2008). The National Taxpayer Advocate first recommended adoption of a UDOC in National Taxpayer Advocate 2001 Annual Report to Congress 82-100.

3 See, e.g., National Taxpayer Advocate 2005 Annual Report to Congress, 397-406; National Taxpayer Advocate 2008 Annual Report to Congress, 363-369; National Taxpayer Advocate 2012 Annual Report to Congress, 508-512; Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>; Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, Tax Policy Center (TPC), <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults>; The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (November 2005); Adam Carasso, Jeffrey Rohaly, and C. Eugene Steuerle, *A Unified Children's Tax Credit*, National Tax Association Proceedings (May 15, 2005), <http://www.urban.org/uploadedPDF/1000790.pdf>; Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Sized Adjustment to the Minimum Wage*, 57 TAX LAW REV. 301 (Spring 2004); Max B. Sawicky, Robert Cherry and Robert Denk, *The Next Tax Reform: Advancing Benefits for Children*, Economic Policy Institute (2002).

4 IRC §§ 1-2.

5 IRC §§ 151-152.

6 IRC § 24.

7 IRC § 32.

- Child and Dependent Care Credit (CDCC);<sup>8</sup> and
- Separated spouse rules.<sup>9</sup>

While literally every tax return involves at least two of these Family Status provisions, the IRS is hard-pressed to independently verify the accuracy of the status claimed. Over the years, it has used different government databases and developed “rules” that assist it in identifying questionable claims of filing status or credits. But these rules fail to account for the fluid nature of household composition. A recent study by the Tax Policy Center found that between 1996 and 2008 the number of households made up of “traditional” families (married parents with only biological children) has declined while alternative family types, such as families led by a single parent and cohabitating parents, has increased.<sup>10</sup> Thus, a narrow conception of a “family” can deny Family Status benefits to many households with children. On the other hand, an overly expansive definition may be impossible for the IRS to administer without unacceptably intrusive inquiries.

Nowhere is this conflict more apparent than in EITC administration. Enacted as a work incentive in the Tax Reduction Act of 1975,<sup>11</sup> the EITC has become one of the government’s largest means-tested anti-poverty programs.<sup>12</sup> Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy “application” process by allowing an individual to claim the benefit on his or her tax return. This approach does not require an infrastructure of case workers and local agencies to make eligibility determinations. For tax year (TY) 2015, over 27 million taxpayers claimed nearly \$67 billion in EITC.<sup>13</sup> Thus, the EITC enjoys a participation rate of between 75 and 79 percent<sup>14</sup> — one of the highest participation rates of any federal government benefit program — and 87 percent of children claimed for the EITC were correctly claimed.<sup>15</sup> However, the easy application process of the EITC is also associated with a high improper payment rate, which must be addressed in any efforts to improve the EITC.<sup>16</sup>

8 IRC §§ 21, 129.

9 IRC § 7703.

10 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, Tax Policy Center (TPC), *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits* 19 (Mar. 3, 2016). The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

11 See Pub. L. No. 94-12, § 204, 89 Stat. 26, 30 (1975) (codified at IRC § 32).

12 Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

13 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc>. For tax year (TY) 2015, 27.3 million taxpayers had claimed \$66.9 billion in EITC (after math error processing, but prior to any audit of the tax return). IRS, Compliance Data Warehouse (CDW), *Individual Returns Transaction File* (includes TY 2015 returns posted as of cycle 47).

14 Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005* 178-179, IRS Research Bulletin (2009). See also Maggie R. Jones, *Changes in EITC Eligibility and Participation, 2005-2009*, U.S. Census Bureau.

15 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 5 (Pub. 5162, August 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf> (hereinafter referenced as *IRS EITC Compliance Study*). The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (*i.e.*, in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (*i.e.*, the default exam exclusion is correct). The upper bound estimate for correctly-claimed children is 73 percent.

16 An improper payment is defined as “any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements” and “includes any payment to an ineligible recipient.” Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e), 124 Stat. 2224, 2227 (2010) (amending Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002) by striking § 2(f) and adding (f)(2)). The IRS currently estimates that the EITC improper payment rate is about 24 percent (which accounts for an estimated \$16.8 billion in improper payments). Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 224 (Nov. 15, 2016).

The IRS National Research Program (NRP) is helpful in identifying the sources of EITC errors. The most common type of EITC error is income misreporting: 65 percent of EITC overclaim returns show some income misreporting and it is the *only* error on 50 percent of overclaim returns.<sup>17</sup> Many of these improper payments should be eliminated by the recent enactment of accelerated due dates for Forms W-2 and 1099-MISC (reporting nonemployee compensation) and the delayed EITC refund issuance date, in effect for the 2017 Filing Season.<sup>18</sup> What remains are some of the more factually complex sources of error, particularly the requirement that the child reside with the taxpayer for more than half the year. Other errors include competing claims for the same child, particularly by separated parents or by persons not having a required relationship with the child, and whether separated parents are considered “unmarried” under the tax code and thus able to file as single or head of household.<sup>19</sup> These issues also arise under other Family Status provisions.

The EITC also provides an extremely small benefit to low income childless workers between the ages of 25 and 64. The participation rate for this benefit is extremely low, even though it is very easy to calculate, because it based on the earnings of a single taxpayer.<sup>20</sup> The IRS does not adjust a taxpayer’s return to claim this credit where the taxpayer has not done so and appears eligible.<sup>21</sup>

Finally, there are areas of EITC administration that can be vastly improved. For example, the IRS has not yet embraced its dual mission as a tax collection and benefits disbursement agency. This failure to acknowledge its role as an administrator of one of the largest anti-poverty programs in the federal government leads to enforcement-oriented compliance approaches that are particularly unsuitable and counter-productive, given the characteristics of the EITC population.<sup>22</sup>

## EXAMPLE

The Tax Court case of *Cowan v. Commissioner* illustrates the counterintuitive operation of the current Family Status rules.<sup>23</sup> In this case, the state of Ohio appointed Ms. Cowan to be the guardian of a child, Marquis, from 1991 until 2004. Under state law, the guardianship automatically terminated when Marquis turned 18, which occurred in 2004. However, Ms. Cowan continued to provide Marquis a home and provided his support after he turned 18, and they continued to regard themselves as a family unit. (The court noted “Ms. Cowan regards Marquis as her son, and Marquis regards Ms. Cowan as his mother.”) Ms. Cowan never adopted Marquis, the legal significance of which she did not understand. Ms. Cowan stipulated for trial that had she known of the importance of adoption, she would have adopted Marquis.

Later, Marquis had a daughter, and they both lived with Ms. Cowan. The court found Ms. Cowan provided most of the household’s support during 2011. In 2011, Ms. Cowan claimed Marquis’s daughter as her granddaughter for the EITC. The court disallowed this claim since Marquis’s daughter was not a qualifying child of Ms. Cowan for purposes of the EITC, *i.e.*, she did not meet the relationship test,

17 IRS EITC Compliance Study (known errors) IV.

18 Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015).

19 IRC § 32(d) requires taxpayers who are married to file jointly in order to receive the EITC; IRC §§ 7703(a) and (b) provide general and special rules for determining marital status.

20 One study estimates the childless worker participation rate at 55.6 percent. Dean Blueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005* 179, IRS Research Bulletin (2009).

21 The IRS will send the taxpayer a notice, advising of the potential eligibility for the credit.

22 For a discussion of the implications of IRS Future State plans for the EITC population, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *supra*.

23 T.C. Memo. 2015-85. See also National Taxpayer Advocate 2015 Annual Report to Congress 242.

despite the fact that Ms. Cowan cared for Marquis's daughter as her own. Moreover, because Marquis's daughter only lived with Ms. Cowan for 11 months of the taxable year, she did not meet the test for Qualifying Relative, which requires the child to have the same principal place of abode as the taxpayer and live as a member of the taxpayer's household for the taxable year.<sup>24</sup>

## RECOMMENDATION

To provide the Code's Family Status provisions with the necessary flexibility to adapt to the evolving U.S. family composition, and to improve the administration of the EITC and other Family Status provisions, including reducing the EITC improper payment rate, the National Taxpayer Advocate reiterates below her 2005 and 2008 legislative recommendations for simplifying the family status provisions in the Internal Revenue Code, and further recommends that Congress:

1. Require the IRS to revise its mission statement to re-emphasize a service-oriented, non-coercive approach to tax administration, recognize the dual roles of revenue collector and benefits administrator, and explicitly affirm the role of the Taxpayer Bill of Rights as the guiding principle for tax administration.<sup>25</sup>
2. Consolidate the numerous family status provisions into two: the refundable Family Credit, which would reflect the cost of maintaining a household and raising a family; and the refundable Earned Income Tax Credit, which would be awarded per individual worker and provide a work incentive and subsidy for low income workers.
3. Repeal the personal and dependency exemptions, Child Tax Credit/Additional Child Tax Credit, Head of Household filing status, and the family-size differential of the EITC, all of which would be replaced by the Family Credit.
4. Make the Family Credit available to all taxpayers regardless of income and refundable to low income taxpayers; the Family Credit would consist of a Personal Credit (for taxpayer and spouse) and a Child Credit available to eligible individuals claiming a "qualifying child" or "qualifying relative" (subject to tie-breaker rules).
5. Amend the Qualifying Relative test of IRC § 152(d)(2)(H) to provide a child must share the same principal place of abode as the taxpayer and be a member of the taxpayer's household for more than six months of the taxable year.
6. Provide for certain add-on credits under the Family Credit for child and dependent care, disabled taxpayers or family members, and consider providing for noncustodial parents of qualifying children who pay substantially all child support legally due for that tax year.
7. Amend IRC § 152(d)(1)(D) to provide the term "qualifying relative" includes an individual "who is not claimed as a qualifying child of such taxpayer or any other taxpayer for any taxable year in the calendar year in which such taxable year begins."
8. Amend IRC § 152(f) to provide a definition of "support" that excludes any means-tested federal, state, or local benefits paid on behalf of or for the benefit of the qualifying child or qualifying relative.
9. Expand the eligibility age for the modified refundable EITC to include workers 18 years of age and older, with no age cap.

<sup>24</sup> Treas. Reg. § 1.152-1(b) explains that the phrase "for the taxable year" means the *entire* taxable year.

<sup>25</sup> For a detailed discussion of the IRS Mission Statement, see Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

10. Amend IRC § 7703(b) to permit taxpayers who have a legally binding separation agreement and who live apart on the last day of the tax year to be considered “not married” for purposes of filing status.
11. Amend IRC § 6402 to limit offsets of refunds attributable to the Family Credit and EITC to 25 percent of the taxpayer’s refundable portion of these credits.
12. Amend IRC § 6402 to authorize the IRS to calculate overpayments and make refunds with respect to the new per-worker EITC refundable credit, where the taxpayer’s reported income demonstrates eligibility and the taxpayer has not claimed the credit on his or her return.
13. Mandate the IRS assign one employee to each audit involving a questionable Family Credit claim where the taxpayer has responded (by phone or in writing) to an IRS audit notice.
14. Mandate the IRS establish a dedicated, year-round toll-free help line staffed by IRS personnel to respond to Family Credit questions.

## PRESENT LAW

The following discussion describes the uniform definition of a child as well as the eligibility requirements for the Family Status provisions of the Code.

### Uniform Definition of a Child

In the Working Families Tax Relief Act of 2004, Congress created a uniform definition of child in IRC § 152(c) of the Code. Beginning in tax year 2005, the Code defines the term “dependent” as a qualifying child or a qualifying relative.<sup>26</sup> The single definition of qualifying child, with certain modifications, applies for purposes of claiming the EITC, CTC, CDCC dependency exemption, and head of household filing status.

<sup>26</sup> IRC § 152(a). If an individual does not meet the definition of a qualifying child under § 152(c), he or she may meet the definition of a qualifying relative under IRC § 152(d).



An individual must meet four tests in order to be a qualifying child under IRC § 152(c): relationship,<sup>27</sup> age,<sup>28</sup> residency,<sup>29</sup> and support.<sup>30</sup> If an individual can be claimed as a qualifying child by more than one taxpayer, IRS § 152(c)(4) establishes a tie-breaker rule to determine which taxpayer can claim the child.<sup>31</sup>

In order to be a qualifying relative of a taxpayer, an individual must: (A) bear a certain relationship to the taxpayer, (B) have gross income for the calendar year that is less than the exemption amount (as defined in IRC § 151(d)), and (C) derive over one-half of his or her support for the calendar year from the taxpayer.<sup>32</sup> In addition, the individual cannot be a qualifying child of the taxpayer or of “any other taxpayer” for the taxable year.<sup>33</sup> A qualifying relative may include an individual who has the same principal place of abode as the taxpayer and who is a member of the taxpayer’s household.<sup>34</sup>

### Earned Income Tax Credit — IRC § 32

The Earned Income Tax Credit (EITC) entitles certain working low income taxpayers to claim a refundable credit of up to \$6,269 for 2016.<sup>35</sup> The EITC is available to taxpayers either with or without a qualifying child. To qualify for the EITC generally, a taxpayer must meet certain general eligibility requirements related to residency,<sup>36</sup> filing status,<sup>37</sup> certain foreign benefits,<sup>38</sup> and status as a qualifying child

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- 27 A qualifying child must be a taxpayer’s son, daughter, stepson, stepdaughter, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them. IRC § 152(c)(2), (f)(1)(A), and (f)(4). In the case of an adopted child, the child is treated as the child of the taxpayer. IRC § 152(f)(1)(B). In the case of an eligible foster child, the child is treated as the child of the taxpayer provided the child was placed with the taxpayer by an authorized placement agency or by the courts. IRC § 152(f)(1)(A)(ii) and (f)(1)(C).
- 28 A qualifying child must be under the age of 19 at the end of the year, under age 24 at the end of the year and a full-time student, or any age if permanently and totally disabled. IRC § 152(c)(3).
- 29 A qualifying child must have the same principal place of abode as the taxpayer for more than half of the taxable year. IRC § 152(c)(1)(B). The Code makes special exceptions for temporary absences, children who were born or died during the taxable year, kidnapped children, and children of divorced or separated parents. IRC § 152(e) and (f)(6); Treas. Reg. §§ 1.152-1(b), and 1.152-2(a)(2)(ii).
- 30 A qualifying child must not have provided more than one-half of his or her own support for the calendar year in which the taxable year begins. IRC § 152(c)(1)(D).
- 31 In cases where more than one taxpayer can claim an individual as a qualifying child, the taxpayers can decide who will treat the child as a qualifying child. The taxpayer who claims the qualifying child is entitled to the dependency exemption for the child, head of household filing status, the Child Tax Credit (CTC), the EITC and the Child and Dependent Care Credit (unless the rule for divorced or separated parents applies and assuming all other eligibility requirements are met). If, however the taxpayers cannot decide who will treat the child as a qualifying child, the tie-breaker rule in IRC § 152(c)(4) determines which taxpayer can claim the child. If only one of the taxpayers claiming a child is the child’s parent, then the child will be treated as the qualifying child of the parent. IRC § 152(c)(4)(A)(i). If both taxpayers claiming a child are the child’s parents, then the child will be treated as the qualifying child of the parent with whom the child resided for the longest period of time during the taxable year. IRC § 152(c)(4)(B)(i). If the child lived with both parents for the same amount of time during the taxable year, then the child will be treated as the qualifying child of the parent with the highest adjusted gross income. IRC § 152(c)(4)(B)(ii). If neither of the taxpayers claiming a child is the child’s parent, then the child is treated as the qualifying child of the taxpayer with the highest adjusted gross income for the taxable year. IRC § 152(c)(4)(A)(ii).
- 32 IRC § 152(d)(1)(A)-(C). The relationship between the qualifying relative and the taxpayer must meet one of the relationships set forth in IRC § 152(d)(2).
- 33 IRC § 152(d)(1)(D).
- 34 IRC § 152(d)(2)(H).
- 35 IRC § 32. The maximum amount of the credit is available to a taxpayer with three or more qualifying children. For tax years beginning in 2016, the maximum credit available for a taxpayer with one qualifying child is \$3,373, with two qualifying children is \$5,572, and with no qualifying children is \$506. Rev. Proc. 2015-53, 2015-44 I.R.B. 615. The actual amount of the EITC varies depending on the earned income of the taxpayer.
- 36 A taxpayer is not eligible for the EITC if he or she is a nonresident alien for any portion of the taxable year, unless the taxpayer files a joint return with a spouse who is a United States citizen or resident alien. IRC § 32(c)(1)(D).
- 37 A taxpayer is not eligible for the EITC if he or she is filing married filing separately. IRC § 32(d).
- 38 A taxpayer is not eligible for the EITC if he or she claims a foreign earned income exclusion or deducts or excludes a foreign housing amount. IRC § 32(c)(1)(C).

of another taxpayer.<sup>39</sup> The taxpayer must also have a taxpayer identification number,<sup>40</sup> earned income,<sup>41</sup> and limited amounts of income.<sup>42</sup> Taxpayers wishing to claim the EITC without a qualifying child must meet additional eligibility requirements, including being between the age of at least 25 and under 65.<sup>43</sup> To be considered a qualifying child for the EITC, an individual must meet the definition of a qualifying child in IRC § 152(c),<sup>44</sup> he or she must be unmarried at the end of the taxable year (unless the taxpayer is entitled to a deduction under IRC § 151 (or would be so entitled but for IRC § 152(e)) for the married individual),<sup>45</sup> and his or her principal place of abode must be in the United States.<sup>46</sup>

### Child Tax Credit — IRC § 24

The CTC entitles a taxpayer to claim a credit of up to \$1,000 for each qualifying child, as defined in IRC § 152(c), who is under age 17 at the end of the tax year.<sup>47</sup> The amount of the credit is applied to any taxes due and in some instances is refundable (known as the Additional Child Tax Credit, or ACTC).<sup>48</sup>

### Child and Dependent Care Credit — IRC § 21

The Child and Dependent Care Credit (CDCC) entitles a taxpayer to claim a credit for expenses incurred so the taxpayer (and spouse, if married) can work or look for work.<sup>49</sup> To qualify for the credit, a taxpayer

39 A taxpayer is not eligible for the EITC if he or she is the qualifying child of another taxpayer. IRC § 32(c)(1)(B).

40 A taxpayer cannot claim the EITC if he or she does not have a valid social security number. IRC § 32(c)(1)(E) and (m).

41 A taxpayer cannot claim the EITC unless he or she has earned income. IRC § 32(a).

42 A taxpayer's earned income, adjusted gross income, and investment income must all be within limits established annually. IRC § 32(a)(2) and (j).

43 A taxpayer is not eligible to claim the EITC without a qualifying child unless the taxpayer's principal place of abode is in the United States for more than half the taxable year, the taxpayer is at least 25 but under age 65 at the close of the taxable year, and the taxpayer does not qualify as a dependent of another taxpayer under IRC § 151 for the taxable year. IRC § 32(c)(1)(A)(ii).

44 IRC § 32(c)(3)(A). For purposes of the EITC, a qualifying child under IRC § 152(c) is determined without regard to IRC § 152(c)(1)(D) (requiring a qualifying child not have provided over one half of his or her own support for the taxable year) and IRC § 152(e) (describing special rules for divorced parents).

45 IRC § 32(c)(3)(B).

46 IRC § 32(c)(3)(C).

47 IRC § 24(a) and (c). The amount of the Child Tax Credit is reduced by \$50 for each \$1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the threshold amount (\$110,000 in the case of a joint return, \$75,000 in the case of a taxpayer who is not married, and \$55,000 in the case of a married taxpayer filing separately). IRC §§ 24(b)(1) and (2).

48 IRC § 24(d).

49 IRC § 21. The amount of the credit is a percentage, based on adjusted gross income, of the amount of employment-related expenses paid by the taxpayer during the taxable year. IRC § 21(a)(2) and (c). A taxpayer may claim a credit of up to 35 percent of child and dependent care expenses paid during a taxable year, up to a maximum of \$3,000 for a taxpayer with one qualifying individual or \$6,000 for a taxpayer with two or more qualifying individuals. IRC § 21(a)(2) and (c). This percentage is reduced one percentage point for every \$2,000 (or fraction thereof) by which the taxpayer's adjusted gross income exceeds \$15,000. IRC § 21(a)(2). A taxpayer may not claim this credit based on household or care expenses paid to a relative who is a dependent of the taxpayer or the taxpayer's child who is not over 19. IRC § 21(e)(6).

must maintain a home for one or more qualified individuals.<sup>50</sup> Additionally, a taxpayer must have earned income,<sup>51</sup> and must meet certain filing status requirements.<sup>52</sup>

### Dependency Exemption — IRC § 151

The dependency exemption entitles a taxpayer to claim an additional exemption for each dependent who is a qualifying child or qualifying relative of the taxpayer, as defined in IRC § 152. A qualifying child must be under the age of 19 at the close of the taxable year, under 24 and a full-time student, or be permanently or totally disabled.<sup>53</sup>

### Head of Household — IRC § 2(b)

Head of household filing status entitles a taxpayer to a larger standard deduction and a more favorable tax rate than a taxpayer filing single or married filing separately.<sup>54</sup> To qualify as a head of household, a taxpayer must be unmarried or “considered unmarried” at the end of the taxable year.<sup>55</sup> For more than half of the taxable year, a taxpayer must maintain, as the taxpayer’s home, a household that is the principal place of abode of a qualifying child<sup>56</sup> or a qualifying relative as defined under IRC § 152(d)(2)(A)-(H), for whom the taxpayer can claim a dependency exemption under IRC § 151.<sup>57</sup> Additionally, the taxpayer can qualify for head of household status if he or she maintains a household which is the principal place of abode of the taxpayer’s mother or father for whom the taxpayer can claim a dependency exemption under IRC § 151.<sup>58</sup>

### Separated Spouse Rule Under IRC § 7703(b)

Under IRC § 7703(a), the determination of whether an individual is married is generally made as of the last day of the individual’s tax year. IRC § 7703(a) prevents taxpayers from being considered as “not

50 IRC § 21(a)(1). A qualified individual is a dependent, defined as a “qualifying child” under IRC § 152(a)(1) who is under the age of 13, a dependent who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the tax year, or a spouse of the taxpayer who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the tax year. IRC § 21(b)(1). Special rules apply for children of divorced or separated parents, allowing only the custodial parent to claim the CTC even if the noncustodial parent claims the child as a dependent under the rules of IRC § 152(e). IRC § 21(e)(5).

51 IRC § 21(d)(1). Special rules apply for calculating the earned income with regard to the spouse of a taxpayer who is a student or who is physically or mentally unable to care for himself or herself. IRC § 21(d)(2).

52 IRC § 21(e)(2).

53 IRC §§ 151(c)(1), 152(a) and (c). For tax year 2016, the dependency exemption amount is \$4,050. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

54 For tax year 2016, the standard deduction for head of household is \$9,300. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

55 IRC § 2(b). A taxpayer whose spouse died during the taxable year is considered married for that year. IRC § 2(b)(2)(C). A taxpayer is not considered as married if he or she is legally separated from his or her spouse under a decree of divorce or separate maintenance or if his or her spouse is a nonresident alien at any time during the taxable year. IRC § 2(b)(2)(A) and (B). A taxpayer is also considered unmarried if he or she is treated as unmarried under the provisions of IRC § 7703. IRC § 2(c).

56 IRC § 2(b)(1)(A)(i), which also contains specific rules for married children. Additionally, for purposes of head of household status, a qualifying child is determined under the rules of IRC § 152(c) but without regard to the rules for divorced or separated parents under IRC § 152(e).

57 IRC § 2(b)(1)(A)(ii). A taxpayer is considered as maintaining a household if the taxpayer provides over half of the cost of maintaining the household for the taxable year. IRC § 2(b).

58 IRC § 2(b)(1)(B).

married” even when they have separated from their spouses pursuant to a binding separation agreement.<sup>59</sup> It provides:

(a) General rule.--For purposes of part V of subchapter B of chapter 1 and those provisions of this title which refer to this subsection--

(1) the determination of whether an individual is married shall be made as of the close of his taxable year; except that if his spouse dies during his taxable year such determination shall be made as of the time of such death; and

(2) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

Neither the statute nor the regulations define the requirements for a “decree of separate maintenance,” but the term may encompass “bed and board” divorces, discussed below.

As an exception to the general rule, IRC § 7703(b) provides that certain married persons who are living apart from their spouses may be treated as unmarried. A married taxpayer (as determined under the general rule of IRC § 7703(a)) living apart with a dependent child will qualify as an unmarried person if each of the following conditions is met:

- The taxpayer must file a separate tax return;
- The taxpayer must pay more than half the cost of maintaining his or her household for the tax year;
- The taxpayer’s spouse must not be a member of the household during the last six months of the tax year; and
- The household must, for more than six months of the year, be the principal home of the taxpayer’s child (as defined in IRC § 152(f)(1)) for whom the taxpayer can claim a dependency exemption, or could claim such an exemption except for the special rules for divorced parents under IRC § 152(e).

### Accelerated Information Reporting and Delay of Certain Refund Issuance

In 2015, Congress enacted two provisions that will assist the IRS enormously in ensuring that credits, deductions, and exclusions that are income-based are correctly claimed. Specifically, Section 201 of the Protecting Americans From Tax Hikes (PATH) Act of 2015 amended IRC § 6071 to require that certain information returns (Forms W-2 and 1099-MISC reporting nonemployee compensation) be filed by January 31, generally the same date as the due date for employee and payee statements, and are no longer

59 IRC § 7703(b) also prevents taxpayers from being considered “not married” in two ways. First, the statute retains an outdated “cost of maintaining a household” test that disproportionately affects members of racial and ethnic minorities who work and have children. Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year’s end. In her 2012 Annual Report to Congress, the National Taxpayer Advocate recommended that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.” National Taxpayer Advocate 2012 Annual Report to Congress 513 (Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married”*).

eligible for the extended filing date for electronically filed returns under section 6071(b).<sup>60</sup> Section 201 of the PATH Act further requires the IRS to hold all refunds that include EITC or the ACTC until February 15 for calendar year filers to allow the IRS more time to verify the validity of the refunds and detect fraud.

### Overpayments and Refund Offsets

IRC § 6402 authorizes the Secretary to both offset a taxpayer's refund against certain liabilities and refund the balance of the overpayment to the taxpayer. The debts against which the refund can offset include outstanding federal tax liabilities, past due child support, debts owed to other federal agencies, state income tax obligations, and Old Age, Survivors and Disability Insurance (OASDI) payments. There is no provision for exclusion of the EITC portion of the overpayment from the offset provisions.<sup>61</sup>

## REASONS FOR CHANGE

The above Present Law discussion demonstrates the mind-numbing complexity of the Code's Family Status provisions. In earlier Reports to Congress, the National Taxpayer Advocate laid out many reasons for amending these provisions.<sup>62</sup> First and foremost, she believes that the tax law should not "entrap" taxpayers, by which she means the laws should not run counter to or disregard the ways taxpayers generally live their lives and conduct their business. Where the laws provide for refundable credits, they should be designed in a way that the IRS can effectively administer.<sup>63</sup> Thus, in the context of the Family Status provisions, we can minimize both IRS and taxpayer burden if we understand the structure of families and households in the U.S. However, the challenge for any simplification proposal relating to the family is how to accommodate evolving family structures without imposing undue burden on taxpayers or creating additional compliance risks. By studying both the demographics of the American family and the sources of error occurring with the current web of Family Status provisions, we can design a statutory scheme that is flexible enough to adapt to the evolution of the family while minimizing taxpayer burden and risk of fraud.

### Demographic Changes in the American Family Unit

A recent paper by the Tax Policy Center (hereinafter TPC Study) found that the number of households made up of "traditional" families (married parents with only biological children) has declined while alternative family types, such as families led by a single parent or cohabitating parents, has increased.<sup>64</sup>

60 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015). This legislative change is consistent with prior National Taxpayer Advocate recommendations. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 45-55; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-88; National Taxpayer Advocate 2012 Annual Report to Congress 180-91; National Taxpayer Advocate 2011 Annual Report to Congress 284-95; National Taxpayer Advocate 2009 Annual Report to Congress 338-45.

61 In *Sorenson v. Secretary of the Treasury*, 475 U.S. 851 (1986), the Supreme Court held that a refund involving EITC that was due to a taxpayer who had failed to meet his child support obligations, could be offset.

62 See, e.g., National Taxpayer Advocate 2005 Annual Report to Congress, 397-406; National Taxpayer Advocate 2008 Annual Report to Congress, 363-369; National Taxpayer Advocate 2012 Annual Report to Congress, 508-512.

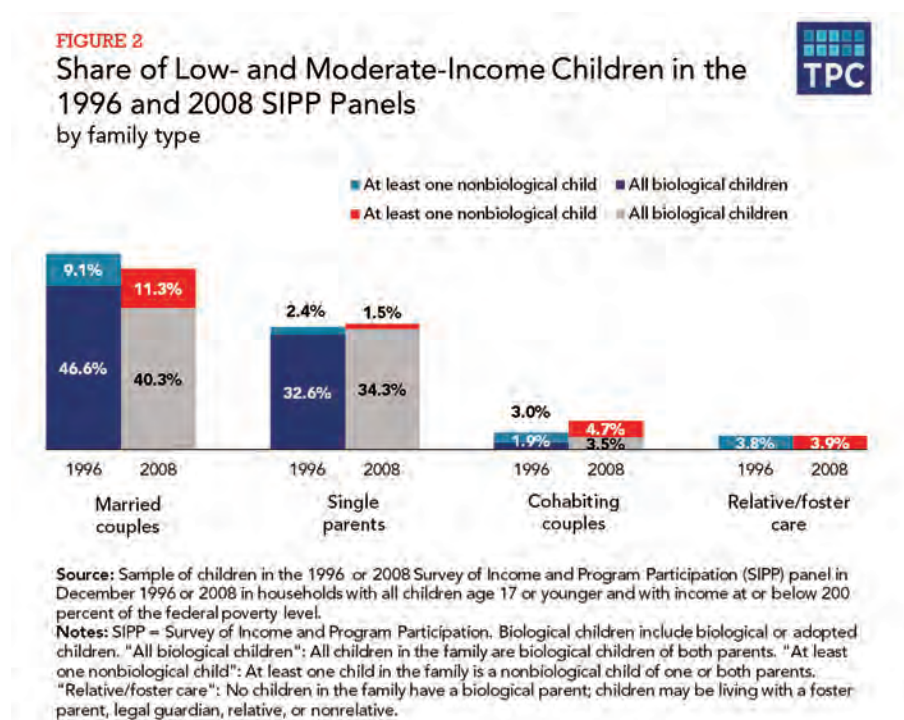
63 The National Taxpayer Advocate previously articulated these and other principles in a presentation to the President's Advisory Panel on Federal Tax Reform. See Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) (statement of Nina E. Olson, National Taxpayer Advocate), [http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/olson\\_03032005.ppt](http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/olson_03032005.ppt). For more detail, see National Taxpayer Advocate 2005 Annual Report to Congress 375-380 (Key Legislative Recommendation: A Taxpayer-Centric Approach to Tax Reform).

64 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits*, TPC 10 (Mar. 3, 2016), [http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full\\_report](http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full_report). The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.



The TPC Study found that between 1996 and 2008, the proportion of children living with married couples dropped from 70.9 percent to 67.3 percent and the number living with cohabitating parents increased from 3.6 percent to 6.2 percent.<sup>65</sup> Furthermore, the TPC Study found that in 2008, nearly 20 percent of children living in single-parent households also lived in multigenerational households.<sup>66</sup> Only 51.6 percent of children living in families with income at or below 200 percent of the federal poverty level (FPL) were in families headed by married couples. The percentage of children living with cohabitating couples at or below 200 percent of FPL increased from just under five percent in 1996 to 8.2 percent in 2008.<sup>67</sup>

**FIGURE 2.1.1**<sup>68</sup>



The percentage of children living in multigenerational households also increased from 1996 to 2008, across all household types. By 2008, almost one-fifth of children living with a single parent also lived in a multi-generational household, as was the case with households headed by non-parent relatives or foster parents.

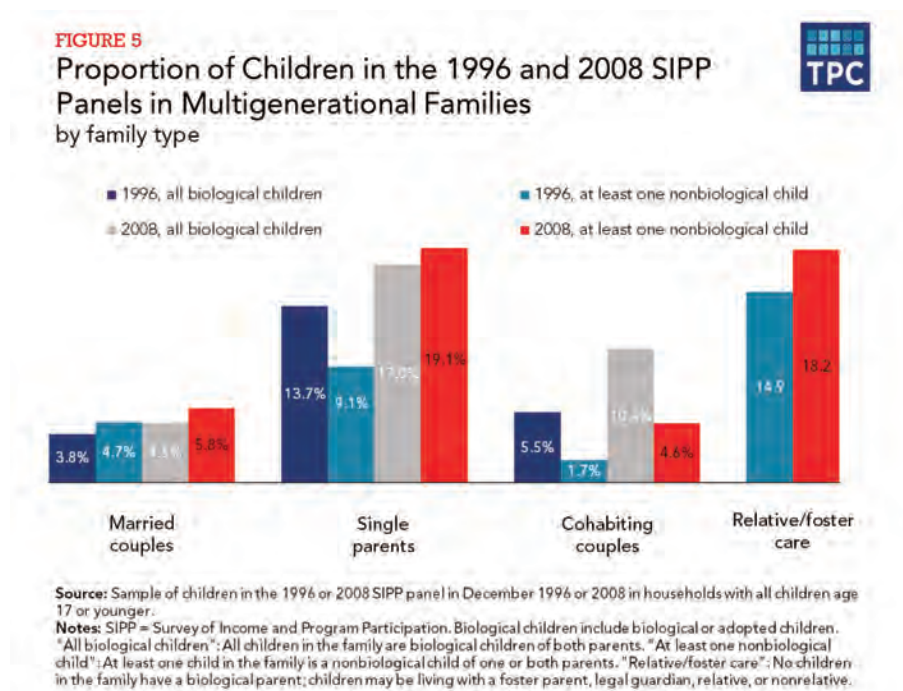
65 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits*, TPC 10 (Mar. 3, 2016), [http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full\\_report](http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full_report). The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

66 *Id.* at 18.

67 *Id.* at 11.

68 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

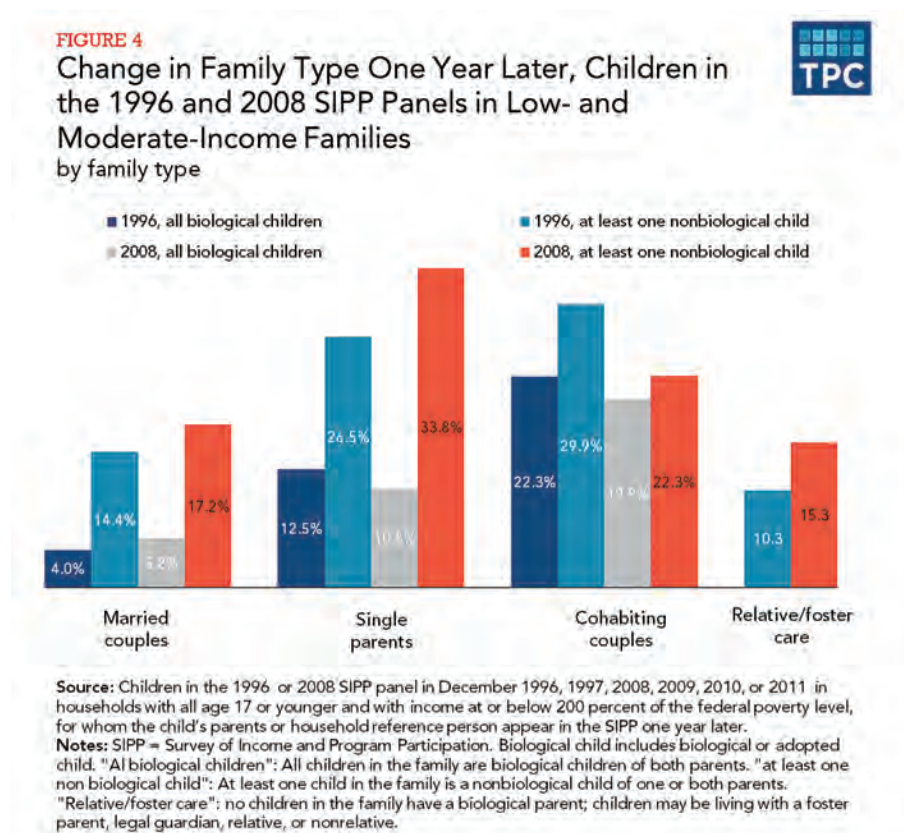


FIGURE 2.1.2<sup>69</sup>

Children who lived in families with married parents and only biologically related children were unlikely to move to different family types from one year to the next, or within a given year, regardless of income level. However, children in low and moderate income single parent families, cohabiting couple families, and relative/foster care families all experienced greater change in family type from one year to the next. For example, in 2008, a third of low and moderate income children in single parent families with some biological children changed family type.<sup>70</sup>

69 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

70 *Id.* at 12, 13.

FIGURE 2.1.3<sup>71</sup>

Finally, across all income levels, "[t]he same types of families who were more likely to change across different tax years are also more likely to change within a tax year (children in cohabiting couple families, single parent families with at least one-biological child, and foster care families)."<sup>72</sup>

71 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

72 *Id.* at 16. The TPC Study authors note that these results are likely a lower bound estimate, because families that experience a change within years are likely to drop out of the survey and thus the changes won't be observed. *Id.* at 15.

FIGURE 2.1.4<sup>73</sup>

TABLE 4

Number of Parent Changes per Year, Children in the 1996 and 2008 SIPP Panels by family type



|                                  | 1996 panel |      |     | 2008 panel |      |     |
|----------------------------------|------------|------|-----|------------|------|-----|
|                                  | 0          | 1    | 2+  | 0          | 1    | 2+  |
| <b>Married couples</b>           |            |      |     |            |      |     |
| All children are biological      | 97.3       | 2.3  | 0.4 | 97.3       | 2.3  | 0.5 |
| At least one nonbiological child | 84.5       | 13.8 | 1.7 | 84.4       | 12.6 | 3.0 |
| <b>Single parents</b>            |            |      |     |            |      |     |
| All children are biological      | 95.1       | 4.2  | 0.7 | 95.5       | 3.8  | 0.8 |
| At least one nonbiological child | 76.2       | 17.9 | 5.9 | 72.0       | 24.4 | 3.7 |
| <b>Cohabiting couples</b>        |            |      |     |            |      |     |
| All children are biological      | 88.7       | 10.6 | 0.8 | 87.4       | 9.5  | 3.1 |
| At least one nonbiological child | 88.3       | 9.6  | 2.2 | 87.7       | 9.4  | 3.0 |
| <b>Relative/foster care</b>      | 86.4       | 11.8 | 1.8 | 86.7       | 11.1 | 2.2 |
| <b>All children</b>              | 94.8       | 4.5  | 0.7 | 94.4       | 4.6  | 1.0 |

Source: Sample of children in the 1996 or 2008 SIPP panel in January 1997, 1998, 2009, 2010, 2011, or 2012 in households with all children age 17 or younger, for whom the child's parents or household reference person appear in the SIPP in the subsequent December.

Notes: SIPP = Survey of Income and Program Participation. Biological children include biological or adopted children. "All children are biological": All children in the family are biological children of both parents. "At least one nonbiological child": At least one child in the family is a nonbiological child of one or both parents. "Relative/foster care": No children in the family have a biological parent; children may be living with a foster parent, legal guardian, relative, or non-relative. A parent change is defined as any child in the family not living with the same parent or parents as in the next month. If a child was not observed but his or her parent or household reference person from January was observed, it is assumed that the child left the household and this is counted as a change. Changes may be underestimated for children who are not observed for all 12 months (or have lived with other children who are not observed all 12 months) because children may have additional parent changes in the months they are not observed. Changes may be underestimated for up to 15 percent of children in 2008 (13 percent if no parent changes, 54 percent if one change, and 57 percent if two or more changes), and up to 12 percent of children in 1996 (9 percent if no parent changes, 58 percent if one change, and 64 percent if two or more changes). Further, changes are underestimated for children with one biological parent who has a cohabiting partner because we only track whether the child is separated from the biological parent because of difficulty establishing the relationship between children and their parents' cohabiting partners that are not biological parents.

The above-described changes in family composition and mutation within and between years is reflected in the EITC data: about one-third of the EITC population changes from year to year.<sup>74</sup> Because the Family Status rules generally contemplate more "traditional" households and award tax benefits to only one person with respect to each child, the disconnect between the Code and the reality of many taxpayers' lives has led to mistakes on the part of taxpayers who misunderstand the rules; it also prevents some primary caregivers for children in certain low income households from receiving the EITC.

The IRS is not alone in facing these challenges. Tax administrations around the world are moving to incorporate some aspects of their benefits system into their tax codes. For example, Australia offers a similar tax credit to the EITC, called the Family Tax Benefit (FTB). The eligibility rules for the FTB are more expansive than for the EITC. For instance, a child qualifies for the FTB if he or she meets these general rules:

- Must be in the adult's care;
- Must meet citizenship requirements;
- Must not meet any exceptions; and

<sup>73</sup> Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

<sup>74</sup> IRS, *EITC Fast Facts*, <http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff> (last visited Dec. 30, 2015). For more information on the changing population of taxpayers eligible for EITC, see National Taxpayer Advocate 2013 Annual Report to Congress 109-10.

- When more than one adult is involved, the child must be in the adult's care for at least 35 percent of the time.<sup>75</sup>

The act of caring for a child in Australia counts for more than just the amount of time the adult resides with the child. The “primary carer” is considered the “member of a couple” having the greater responsibility for the child. This is determined by identifying who has major daily responsibility for the child, looks after the child's needs (such as dressing and bathing), makes appointments for the child, is the primary contact for daycare or school, and transports the child to and from school.<sup>76</sup> When it is determined that more than one adult cares for a child, the percentage of FTB allocated to each individual is based on “issues of fairness and appropriateness, taking into account equity considerations and sharing and pooling within a family unit that can result in a 50:50 split in FTB.”<sup>77</sup> Under this system there is an acknowledgement that many families operate on a fluid, day-to-day basis where the care of a child does not fall on just one relative. There is also a provision for splitting the FTB between two primary carers, by agreement between the parties.<sup>78</sup>

### *The Administrative Justification for Running Social Benefits Through the Tax System*

Any analysis of Family Status benefits must confront the issue of whether the tax system is the appropriate entity for administering social benefit programs. As we discuss in this and earlier reports, running social programs through the Code requires the tax administrator to think differently about its mission and develop new approaches to compliance and education.<sup>79</sup> The IRS may be an appropriate conduit for social expenditures where it possesses significant data that are key components of eligibility determinations.

One area of tax administration that has both warranted and received a great deal of attention over the years is refundable credits, particularly the EITC.<sup>80</sup> Most credits merely reduce the amount a taxpayer owes, but in the case of *refundable* tax credits, the IRS may end up paying a taxpayer more than the taxpayer paid in tax, resulting in a “negative” tax. Refundable credits may have become familiar in the context of benefits to low income taxpayers and therefore may be viewed as a form of “welfare.” Nevertheless, these credits are no longer limited to this population but are now available to middle-income taxpayers and businesses as well.<sup>81</sup>

75 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.10, FTB Child, <https://guides.dss.gov.au/familyassistance-guide/2/1/1/10>.

76 Australian Department of Social Services, *Family Assistance Guide*, 1.1.P.120, Primary Carer (FTB, Baby Bonus), <http://guides.dss.gov.au/family-assistance-guide/1/1/p/120>.

77 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.25, Shared Care of an FTB Child, <http://guides.dss.gov.au/family-assistance-guide/2/1/1/25>.

78 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.10, <https://guides.dss.gov.au/family-assistance-guide/2/1/1/10>. Here is an example provided: Emily lives primarily with her parent Dave and his new partner Anthony. Emily is an FTB child of both Dave and Anthony. They agree that Anthony should receive FTB for Emily, as he is the stay-at-home parent.

79 See Legislative Recommendation: *Tax Reform: Simplify the Internal Revenue Code Now*, *supra*; National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-19 (*Evaluate the Administration of Tax Expenditures*). See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (*Running Social Programs Through the Tax System*).

80 For a comprehensive discussion of the challenges in administering the EITC, see *Improper Payments in the Administration of Refundable Credits*, *Hearing Before the H. Comm. on Ways and Means*, 112th Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate).

81 See, e.g., the adoption credit (IRC § 36C) and the American Opportunity Tax Credit (IRC § 25A) for low and moderate income taxpayers and the fuel tax credit for purchasers of gasoline used on farms or local buses or of fuels for certain other purposes (IRC §§ 34, 4081(b)(2), 6420, 6421, 6427).

Enacted as a work incentive in the Tax Reduction Act of 1975,<sup>82</sup> the Earned Income Tax Credit (EITC) has become one of the government’s largest means-tested anti-poverty programs. Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy “application” process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of caseworkers and local agencies. According to the IRS, EITC administration costs are less than one percent of benefits delivered, as compared to other non-tax benefits programs in which administrative costs related to determining eligibility can range as high as 42 percent of program expenditures, as shown in Figure 2.1.5 (see endnote in Appendix A). Moreover, a front-end application process would not eliminate improper payments. To assess how well the EITC stacks up against other social benefits programs, the sum of each program’s overhead costs and improper payments should be considered (rather than just overhead costs or improper payments in isolation).

82 See Pub. L. No. 94-12, § 204, 89 Stat. 26, 30 (1975) (codified at IRC § 32).

**FIGURE 2.1.1.5, Costs and Benefits of Federal Payment Programs**

| Program   | SNAP       | WIC        | SSI           | TANF          | HUD        | CHIP          | Medicaid      | School Lunch | EITC       |
|---|------------|------------|---------------|---------------|------------|---------------|---------------|--------------|------------|
| Year  | FY 2013    | FY 2010    | FY 2012       | FY 2011       | FY 2013    | FY 2012       | FY 2013       | FY 2013      | FY 2014    |
| Number of Recipients  | 47.6 mil   | 9.1 mil    | 8.3 mil       | 4.6 mil       | 4.7 mil    | 8.1 mil       | 55.0 mil      | 30.7 mil     | 27.8 mil   |
| Number of Eligible Persons                                  | 51.9 mil   | 14.6 mil   | 13.0-14.3 mil | 12.2-14.4 mil | 9.1 mil    | 11.8-12.2 mil | 76.0-80.6 mil | 49.2 mil     | 22.7 mil   |
| Participation Rate (# of Recipients/ # of Eligible Persons) | 79.0%      | 62.6%      | 58.0%         | 32.0%         | 49.3-51.5% | 66.9 - 68.8%  | 68.2%         | 54.3-64.3%   | 78.8%      |
| Year Participation Rate Measured                            | FY 2011    | CY 2010    | 1998          | 2009          | 2013       | FY 2012       | 2009          | 2012         | TY 2009    |
| Total Benefits Paid Out                                     | \$76.1 bil | \$4.6 bil  | \$51.1 bil    | \$15.2 bil    | \$30.9 bil | \$8.5 bil     | \$248.3 bil   | \$11.3 bil   | \$60.3 bil |
| Average Benefit per Recipient                               | \$133.07   | \$500.86   | \$6,156.54    | \$3,300.84    | \$6,574.47 | \$1,047.64    | \$4,514.55    | \$368.39     | \$2,384.32 |
| Overhead Costs  | \$3.9 bil  | \$1.9 bil  | \$3.8 bil     | \$1.5 bil     | \$4.3 bil  | \$3.1 bil     | \$11.7 bil    | \$1.2 bil    | \$0.6 bil  |
| Overhead Costs as % of Total Benefits Paid Out              | 5.1%       | 41.8%      | 7.4%          | 9.7%          | 13.8%      | 36.3%         | 4.7%          | 10.3%        | 1.0%       |
| Improper Payments   | \$2.6 bil  | \$0.04 bil | \$4.7 bil     | \$2.3 bil     | \$1.3 bil  | \$0.7 bil     | \$14.4 bil    | \$1.8 bil    | \$14.5 bil |
| Improper Payments as a % of Total Benefits Paid             | 3.4%       | 1.0%       | 9.2%          | 15.0%         | 4.3%       | 8.2%          | 5.8%          | 15.7%        | 24.0%      |
| Overhead Costs + Improper Payments                          | \$6.5 bil  | \$1.9 bil  | \$8.5 bil     | \$3.8 bil     | \$5.6 bil  | \$3.8 bil     | \$26.1 bil    | \$3.0 bil    | \$15.1 bil |
| Overhead Costs + Improper Payments as a % of Total          | 8.5%       | 42.8%      | 16.6%         | 24.7%         | 18.1%      | 44.5%         | 10.5%         | 26.0%        | 25.0%      |

See figure and related end notes in Appendix A following this Legislative Recommendation.



This table demonstrates that for a program of such significant size, administered at a federal level, the EITC reaches an extraordinary number and percentage of eligible taxpayers at a modest cost, when overhead and overclaims are considered together.<sup>83</sup> The Treasury Inspector General for Tax Administration has noted that for “other non-tax benefits programs ... administrative costs related to determining eligibility can range as high as 20% of program expenditures.”<sup>84</sup> The IRS reports that it paid \$66.7 billion in EITC claims for TY 2014. If this amount had been paid by another agency that spent 20 percent of program expenditures verifying eligibility, the administrative costs to the government would have been \$13.3 billion — more than 90 percent of the amount of improper payments that the IRS estimates were made.<sup>85</sup>

However, ease of application and the absence of eligibility interviews result in greater overclaims for the EITC than traditional anti-poverty programs. In other words, the front-end administrative costs of traditional anti-poverty programs have shifted to the post-claim compliance costs of the EITC.

A significant positive difference is that the EITC has far higher participation rates than other anti-poverty programs (*i.e.*, the percentage of eligible individuals and families who receive the benefit is much greater, at between 75 and 79 percent).<sup>86</sup> Assuming we want the intended beneficiaries to receive the benefits enacted by Congress, the EITC is a highly effective, and even efficient, method of delivery.

### Understanding the Types of EITC Errors Will Improve the Design of Family Status Benefits

Notwithstanding the EITC’s effectiveness and efficiency, it has frequently been identified as a significant source of improper payments,<sup>87</sup> with Treasury estimating them as averaging about 25 percent of EITC claims over the last five years.<sup>88</sup> Although the improper payment rate is often presented as a worsening problem, it may actually be less severe than in TY 1999.<sup>89</sup> For context, EITC overclaims account for just 3.4 percent of the gross tax gap, 3.8 percent of the net tax gap, and 5.9 percent of gross individual income

83 Unless otherwise noted, the amount of benefits is taken directly from or imputed from the federal government’s improper payment website (see endnotes in Appendix A). Administrative costs were often difficult to determine, and it is not clear that they are computed uniformly by each agency. The figures in the chart were computed by TAS Research from publicly available sources. See Endnotes, *infra*, for more details on the sources of data for each program as well as other information and caveats regarding the data.

84 See TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income tax Credit Payments Each Year 1* (2011) (IRS response).

85 Department of the Treasury, *Fiscal Year 2015 Agency Financial Report* 196 (Nov. 16, 2015). The lower bound estimate of improper EITC payments in FY 2015 is \$14.2 billion.

86 See IRS, *EITC Participation Rate by States*, <http://www.eitc.irs.gov/EITC-Central/Participation-Rate>. See also Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005 178-79*, IRS Research Bulletin (2009); Maggie R. Jones, *Changes in EITC Eligibility and Participation, 2005-2009*, U.S. Census Bureau.

87 See footnote 14, *supra*. See also GAO, GAO-09-628T, *Improper Payments: Progress Made but Challenges Remain in Estimating and Reducing Improper Payments*, App. I, at 20 (Apr. 22, 2009) (identifying EITC as the Treasury improper payment).

88 Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 197 (Nov. 15, 2016) (“The most recent projection is based on a tax year 2012 reporting compliance study that estimated the rate of improper over claims for fiscal year 2016 to range between 22.2 percent (lower bound) and 25.9 percent (upper bound). This amounts to between \$15.5 and \$18.1 billion of approximately \$65.2 billion in total program payments ... [these estimates are] consistent in magnitude with the five-year average 24 percent error rate.”). See also Government Accountability Office (GAO), *Government-Wide Estimates and Use of Death Data to Help Prevent Payments to Deceased Individuals*, GAO-15-482T 4 (Mar. 16, 2015) (suggesting that for FY 2014 there were \$17.7 billion in improper EITC payments, representing an error rate of 27.2 percent).

89 See IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 3 (Feb. 28, 2002), [https://www.irs.gov/pub/irs-utl/1999\\_compliance\\_study\\_022802.pdf](https://www.irs.gov/pub/irs-utl/1999_compliance_study_022802.pdf) (“Of the estimated \$31.3 billion in Earned Income Tax Credit (EITC) claims made by taxpayers who filed returns in 2000 for tax year 1999, it is estimated that between \$8.5 and \$9.9 billion (27.0 percent to 31.7 percent) should not have been paid.”).

tax noncompliance, while business income underreported by individuals accounts for 47.3 percent.<sup>90</sup> Improper EITC payments nonetheless continue to present a problem that cannot be ignored.

While the improper payment rate provides us with a consistent net measure of improper EITC payments (*i.e.*, improper payments actually made), it is important to understand the sources of error for total (gross) EITC overclaims in order to develop targeted strategies to reduce the Improper Payment rate. The most recent IRS National Research Program (NRP) EITC results are useful in this regard, because they provide a statistically representative sample from which to draw observations of taxpayer behavior and better understand the sources of EITC noncompliance and, by extension, identify opportunities for legislative reform of the Family Status provisions.<sup>91</sup>

As a threshold matter, the NRP Compliance Study found that *about 87 percent lower-bound estimate, or LBE, of the qualifying children claimed for EITC are claimed correctly.*<sup>92</sup> Moreover, many EITC overclaims are less than \$500 (44 percent LBE), and relatively few overclaims are above \$3,000 (11 percent LBE). NRP data show that income misreporting is by far the most common type of EITC error.<sup>93</sup> Sixty-seven percent of EITC overclaim returns show some income misreporting, and it is the *only* error on 50 percent of overclaim returns. The average overclaim on income-error-only returns is \$673.<sup>94</sup> Although the average amount of this type of overclaim is relatively modest, if the IRS is able identify the income misreporting upfront, it will eliminate a significant number of overclaims. The recent legislative changes accelerating third-party information reporting and delaying EITC refund issuance until February 15 go a long way to addressing this source of error.

90 IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012). The IRS estimates \$264 billion in individual income tax underreporting for tax year (TY) 2006 with \$125 billion of this amount attributable to business income underreported by individuals as sole proprietors on Schedule C (Profit or Loss from Business) or as farmers on Schedule F (Profit or Loss from Farming). Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 197 (Nov. 15, 2016). The IRS provided a lower bound estimate of \$15.5 billion in EITC overclaims for FY 2016 (\$15.5 billion / \$264 billion is about 5.9 percent).

91 The IRS created the National Research Program (NRP) in 2000 to “develop and monitor strategic measures of taxpayer compliance.” National Research Program, at [http://www.irs.gov/uac/National-Research-Program-\(NRP\)](http://www.irs.gov/uac/National-Research-Program-(NRP)) (last visited on Feb. 19, 2014). NRP is a comprehensive effort by the IRS to measure payment, filing, and reporting compliance for different types of taxes and various sets of taxpayers and to deliver the data to the Business Operation Divisions to meet a wide range of needs including support for the development of strategic plans and improvements in workload identification. Internal Revenue Manual (IRM) 4.22.1.3, *The National Research Program (NRP)* (Apr. 25, 2008). The NRP Compliance Study distinguishes between “known errors” and “unknown errors.” It estimates that 30 percent of total possible overclaim returns and 41 percent of total possible overclaim dollars stem from unknown errors (*i.e.*, cases where compliance and errors are unknown mostly because of audit non-participation). Nevertheless, based on audit participants, the IRS believes it can reliably project 8.4 million overclaim returns and \$11.4 billion overclaim dollars to the EITC population. IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 15 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

92 The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (*i.e.*, in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (*i.e.*, exam exclusion is correct). IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 5 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

93 The IRS uses the NRP to meet its need for current compliance information. The IRS established the NRP office in 2000 as part of its efforts to develop and monitor strategic measures of compliance. The program seeks to increase public confidence in the fairness of the tax system by helping the IRS identify voluntary compliance problems. Information from NRP intranet site, <http://nrp.web.irs.gov/default.aspx>.

94 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 17 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

Qualifying child (QC) errors occur less than half as often and they are less likely to be the only error:

- About 30 percent of overclaim returns show a qualifying child error, and it is the *only* error on 15 percent of overclaim returns.
- The average overclaim on QC-error-only returns is \$2,327.<sup>95</sup>

Finally, nine percent of overclaim returns have *both* QC errors and income misreporting, and twelve percent of overclaim returns have *neither* QC nor income errors.<sup>96</sup> Figure 2.1.6 shows the five *most costly* error types and their percentages of total overclaim dollars.

**FIGURE 2.1.6, Most Costly EITC Errors**<sup>97</sup>

| Error Type  | Lower Bound Estimate |
|---|----------------------|
| Qualifying Child Error  | 51.4%                |
| Self-Employment Income Misreporting                                     | 22.9%                |
| Filing Status Errors  | 16.4%                |
| Income Reporting of Investment Income and AGI (excluding earned income) | 7.9%                 |
| Wage Income Misreporting  | 5.7%                 |

Figure 2.1.7 shows the four *least costly* error types and their percentages of total overclaim dollars. Note that “tiebreaker” errors — where more than one eligible person claims a qualifying child — are now trivial, compared with the 1999 Compliance Study, when tiebreaker errors accounted for 17 percent or more of overclaim dollars.<sup>98</sup> The tiebreaker rules were significantly modified and clarified in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA);<sup>99</sup> the NRP Compliance Study data show the positive impact legislative clarification can have on compliance.

95 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 17 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

96 *Id.* at 16.

97 *Id.* at 19, Table 5.

98 See IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 21 (Feb. 28, 2002), [https://www.irs.gov/pub/irs-utl/1999\\_compliance\\_study\\_022802.pdf](https://www.irs.gov/pub/irs-utl/1999_compliance_study_022802.pdf).

99 Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 303, 115 Stat. 38, 55 (2001). Tiebreaker rules under EGTRRA stipulate that if a child is claimed by more than one eligible person, the credit would first go to the biological parent. If there are two claims between non-parental family members, the credit will go to the family member with the highest adjusted gross income. If two parents do not file a joint return, the credit will go to the parent with whom the child resided for the longest time during the tax year. If residency was split equally between two parents, the credit will go to the parent with the highest adjusted gross income.

**FIGURE 2.1.7, Least Costly EITC Errors**<sup>100</sup>

| Error Type   | Lower-Bound Estimate |
|--|----------------------|
| Rules for All Taxpayer Claiming the EITC Having a Valid SSN, Being a U.S. Citizen or Resident Alien All Year, Not Filing Form 2555 or Form 2555-EZ, Not Being a Qualifying Child of Another Person | 5.0%                 |
| Errors Corrected in Processing Includes Math Errors and Other Adjustments Made Prior to NRP Exam   | 3.0%                 |
| Tiebreaker Errors  | 1.0%                 |
| Rules for Taxpayers Claiming EITC Without Children (Being Age 25-64, Not a Dependent of Another Taxpayer, and Having a Home in the U.S. for More Than Half the Year)                               | 0.0%                 |

As a practical matter, low income taxpayers have considerable difficulty documenting relationship and residence — principal components of the qualifying child test — because of a lack of clarity from the IRS as well as their personal circumstances.<sup>101</sup> In the past, TAS has reported that the “two main problems are inconsistency as to which documents the IRS will accept (a document is accepted in one office, but not in another) and inflexibility in accepting proof (failure to accept other types of documents where the taxpayer cannot provide standard documentation).”<sup>102</sup> On the low income taxpayers’ part, one of the biggest issues is “their tendency to be transient or even temporarily homeless” coupled with literacy challenges.<sup>103</sup> The TPC Study findings relating to changes in household composition add to these challenges in proving eligibility. The combination of byzantine requirements with the lack of a home in which to store documents, not to mention the skills needed to read or retain them, frequently results in a lack of documentation.

Of the 13 percent of “knowable” QC errors,<sup>104</sup>

- 75 percent were attributable to the residency test;
- 20 percent were attributable to the relationship test;
- Seven to ten percent were each attributable to the age test, an invalid Social Security number, and the tiebreaker rules;
- One percent to a married child;
- One percent to errors corrected in processing; and
- 11 percent to unknown errors (*i.e.*, the taxpayer acknowledged the error but gave no detail, or it was an “operational exam”).

100 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Return* 19, Table 5, (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

101 See Leslie Book, *EITC Noncompliance: What We Don't Know Can Hurt Them*, 2003 TAX NOTES TODAY 121-27 (June 23, 2003); Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 KANS. L. REV. 1145 (2003), [http://works.bepress.com/leslie\\_book/8](http://works.bepress.com/leslie_book/8); National Taxpayer Advocate 2002 Annual Report to Congress 50 (Most Serious Problem: *EITC Eligibility Determinations Can Be Made Less Burdensome*).

102 National Taxpayer Advocate 2005 Annual Report to Congress 106-07 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*).

103 Leslie Book, *The IRS's EITC Compliance Regime: Taxpayers Caught in the Net*, 81 ORE. L. REV. 351, 393 (2002). See also National Taxpayer Advocate 2015 Annual Report to Congress, Introduction: *The IRS Can Do More to Improve Its Administration of the Earned Income Tax Credit and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights* 235-39.

104 IRS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 23 (Pub. 5162, Aug. 2014).

Thus, not surprisingly in light of the demographic data presented above, the residency test appears to present the greatest challenge to EITC claimants. Reform efforts should focus on improving otherwise eligible families' ability to satisfy this requirement while minimizing opportunities for error or fraud. By combining the "family" component of the EITC with the other Family Status provisions, the "qualifying relative" definition will apply. Households that were previously ineligible because the primary caregiver did not have the requisite relationship under IRC § 32 will now be eligible for family benefits. Moreover, by requiring the IRS to utilize a Household/Residency Affidavit(s) as an attachment to the tax return where a non-biological primary caregiver is claiming the EITC, Congress can minimize the risk of error or fraud in such claims.<sup>105</sup>

### Age Eligibility for Childless Worker EITC or Reformed Worker Credit

In TY 2017, the maximum amount of EITC benefits available to taxpayers without children will be \$510, whereas the maximum amount of benefits for taxpayers with just one child will be \$3,400.<sup>106</sup> This is a troubling disparity, considering that a little over 20 percent of Millennials with only a high school education are living in poverty.<sup>107</sup> Additionally, 4.2 million people aged 65 and older were living in poverty in 2015 (representing a poverty rate of 8.8 percent among people age 65 and over).<sup>108</sup> Yet, the childless worker portion of the EITC is limited to workers between the ages of 25 and 64.<sup>109</sup> As the data discussed below show, this age limitation harms significant segments of the population that could benefit from this income supplement.

For example, the allocation of benefits provided to childless workers does not address the recent trend in delaying the decision to start a family. The birth rate for women ages 20–24 has fallen to approximately 77 percent, a measurement which has steadily declined since 2007.<sup>110</sup> One report ties this trend to the increased cost of childrearing and the bleak financial situation for many taxpayers in this age bracket (referred to as Millennials).<sup>111</sup>

When Congress initially implemented the EITC, one explanation for not making EITC universally available to everyone was that students and retired individuals "often have low amounts of earned income because they work part-time or for short periods of time and may receive most of their support from family relatives or through social security or private pension plans."<sup>112</sup> However, only 33 percent of Americans have a Bachelor's degree or higher, meaning it is a mistake to assume taxpayers under age 25

<sup>105</sup> For a discussion on the use of affidavits and EITC cases, see National Taxpayer Advocate 2015 Annual Report to Congress 253-54.

<sup>106</sup> See Rev. Proc. 2016-55, 2016-45 I.R.B. 707. See also IRS, *2017 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates*, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts-next-year> (last visited Dec. 31, 2016).

<sup>107</sup> Pew Research Center, *The Rising Cost of Not Going to College* (Feb. 11, 2014), <http://www.pewsocialtrends.org/2014/02/11/the-rising-cost-of-not-going-to-college/>.

<sup>108</sup> U.S. Census Bureau, *Income and Poverty in the United States: 2015* 14 (Sept. 2016).

<sup>109</sup> IRC § 32(c)(1)(A)(ii)(II).

<sup>110</sup> Center for Disease Control, *National Vital Statistics Report 2* (June 6, 2016).

<sup>111</sup> Jessica Grose, *For Many Millennials, Children Are Out of Reach*, N.Y. TIMES, Dec. 25, 2014.

<sup>112</sup> *Tax Reduction Act of 1975: Report of the Sen. Comm. on Finance Together with Supplemental Views on H.R. 2166*, S. REP. NO. 94-36 at 33 (1975).

are primarily students.<sup>113</sup> Furthermore, ignoring the needs of this population may go against the intent of the EITC since earnings can be tied to level of education, meaning those with less education will earn less.<sup>114</sup>

It is also no longer realistic to assume older taxpayers can safely rely on pensions and Social Security. One survey by the Board of Governors of the Federal Reserve System found that 31 percent of non-retired respondents had no retirement savings or pension.<sup>115</sup> Congress's original rationale for age limits results in the EITC being unavailable for younger taxpayers who do not obtain a college education and who work lower-paying jobs, as well as elderly taxpayers who have little or no savings or pension.

Figure 2.1.8 shows the number of workers eligible for the childless worker EITC under current income eligibility rules, if the age limits were expanded as recommended.

**FIGURE 2.1.8, Workers Eligible for the Childless Worker EITC Under Current Income Eligibility Rules, If Age Limits Were Expanded As Recommended<sup>116</sup>**

| Category                           | Count            | Average         | Sum                       |
|------------------------------------|------------------|-----------------|---------------------------|
| Single no child filers <25 or >64  | 3,131,980        | \$291.52        | \$913,043,008.00          |
| Married no child filers <25 or >64 | 319,354          | \$308.36        | \$98,475,444.00           |
| <b>Total</b>                       | <b>3,451,334</b> | <b>\$293.08</b> | <b>\$1,011,518,452.00</b> |

Expansion of the childless worker EITC credit appears to have bipartisan support.<sup>117</sup> In addition to expanding the age eligibility for the EITC, Congress should also consider converting the work incentive component of the EITC to a per person credit. One policy aspect of this reform is whether the amount of the “worker” credit should be increased, with a requisite adjustment to the amount of the bifurcated

113 U.S. Census Bureau, *Educational Attainment in the United States: 2015* 1 (Mar. 2016), <http://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf>. Education levels vary among race and other characteristics.

For instance, 36.2 percent of non-Hispanic Whites aged 25 years and older had a Bachelor's degree or more, whereas only 22.5 percent of Blacks and 15.5 percent of Hispanics aged 25 years and older attained a Bachelor's degree or more.

U.S. Census Bureau, *Educational Attainment in the United States: 2015* 2 (Mar. 2016), <http://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf>.

114 While many factors affect a worker's lifetime earnings, workers with an education to eighth grade can expect to earn \$936,000 in life-time earnings, compared to \$4,159,000 in life-time earnings for a worker with a professional degree. U.S. Census Bureau, *Work-Life Earnings by Field of Degree and Occupation for People With a Bachelor's Degree: 2011* 4 (Oct. 2012), <http://www.census.gov/prod/2012pubs/acsbr11-04.pdf>.

115 Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014* 38-39 (May 2015). According to the survey, the rate of retirement savings is tied directly to an individual's income. Eighty-two percent of the respondents making over \$100,000 per year had at least some retirement savings or pension. Meanwhile, among respondents making under \$40,000 per year, only 42 percent had any retirement savings. Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014* 38-39 (May 2015).

116 Figure 2.1.8 is based on Tax Year 2015 data from the Individual Returns Transaction File (returns posted through week 47 of 2016) for single filers without children under age 25 or over age 64 and returns for married filers without children where both taxpayers are under age 25 or over age 64.

117 Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2017* 48 (2016) (including a proposal to double the childless worker credit). See also Richard Rubin and Eric Morath, *Obama, Ryan See Potential for a Tax-Policy Compromise*, WALL ST. J., Feb. 2, 2016; and Center on Budget and Policy Priorities, *Reports Bolster Calls to Expand EITC For Childless Workers* (Sept. 6, 2016), <http://www.cbpp.org/blog/reports-bolster-calls-to-expand-eitc-for-childless-workers>.



Family Credit.<sup>118</sup> Now that the IRS has access to the majority of earned income information returns during the early part of the filing season, the IRS can easily verify eligibility for an income-based, per-person credit in real time, thereby minimizing improper payments. Because the revised EITC would be granted on a per-worker basis (and no longer a function of family composition), the IRS should adjust returns (post-income verifications) that appear eligible for the credit but did not claim it, and issue refunds in the appropriate cases.

### The Definition of “Not Married” Under IRC § 7703(a) Should Be Amended to Reflect 21st Century Family Law

As noted above, IRC § 7703(a) prevents taxpayers from being considered as “not married” even when they have separated from their spouses pursuant to a binding separation agreement. Specifically, it provides an individual legally separated from his spouse on the last day of the taxable year under a “decree of divorce or of separate maintenance” shall not be considered as married. Neither the statute nor the regulations define the requirements for a “decree of separate maintenance.”

Judicially-sanctioned separations generally may have arisen due to the historical unavailability in Anglo-American law of decrees of absolute divorce.<sup>119</sup> Some Southern colonies — Virginia, Maryland, North Carolina, South Carolina, and Georgia — that did not permit absolute divorce did allow divorce *a mensa et thoro*, or bed and board divorce.<sup>120</sup> Bed and board divorce, still available in some jurisdictions, refers to spousal separation in which the parties do not live together, but the marriage itself, with attendant support obligations, is left undisturbed.<sup>121</sup>

Judicial separation is now available in at least 40 States.<sup>122</sup> However, judicial separation is not necessarily a prerequisite to divorce. Some form of no-fault divorce is now available in all States, and is the *sole* ground for divorce in at least 17 States. The need for decrees of legal separation (or, to the extent they differ, decrees of separate maintenance) is presumably lessened. At the same time, separation agreements executed by spouses, who may serve the same purpose as a “decree of separate maintenance,” are encouraged as a matter of public policy.<sup>123</sup> Thus, amending IRC § 7703(a)(2) to clarify that the term “decree of separate maintenance” includes a separation agreement entered into by spouses and in existence as of the last day of the calendar year (or adding a separation agreement clause to the statute), would align the Code’s Family Status determinations to present-day family law practice and reclassify some EITC claimants as eligible, thereby reducing the improper payment rate.

118 See Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, TPC, <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults> (estimating a 15.3 percent per worker benefit up to \$1,500 would reach almost 42 million workers currently not eligible for today’s childless worker EITC). See also Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>.

119 See Mary Frances Lyle and Jeffrey L. Levy, *From Riches to Rags: Does Rehabilitative Alimony Need to be Rehabilitated?* 38 FAM. L.Q. 3, 4-5 (Spring 2004).

120 See Michelle L. Evans, *Wrongs Committed During A Marriage: The Child That No Area of the Law Wants to Adopt*, 66 Wash. & Lee L. Rev. 465 n 47 (Winter 2009) (citing Nelson Manfred Blake, *THE ROAD TO RENO: A HISTORY OF DIVORCE IN THE UNITED STATES* 34-47 (Greenwood Press 1977) (1962)).

121 See Mary Frances Lyle and Jeffrey L. Levy, *From Riches to Rags: Does Rehabilitative Alimony Need to be Rehabilitated?* 38 FAM. L.Q. 3, 4-5 (Spring 2004). See also, e.g., Va. Code § 20-95, providing that “A divorce from bed and board may be decreed for cruelty, reasonable apprehension of bodily hurt, willful desertion or abandonment.”

122 Some statutes refer to decrees for maintenance. See, e.g., Ark. Code § 9-12-313. Others refer to legal separation. See, e.g., Conn. Gen. Stat. § 46b-40; 750 Ill. Comp. Stat. 5/402; Mont. Code § 40-4-104; Vt. Stat. tit. 15 § 555. Yet others refer to bed and board. See, e.g., DC Code § 16-904; Ky. Rev. Stat. § 403.050; NJ Stat. § 2A:34-6; NC Gen. Stat. § 50-7; Va. Code Ann. § 20-95. For details about judicial separation in the 50 states, see [http://www.americanbar.org/content/dam/aba/publications/family\\_law\\_quarterly/vol45/4win12\\_chart4\\_divorce.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/family_law_quarterly/vol45/4win12_chart4_divorce.authcheckdam.pdf).

123 See, e.g., Uniform Marriage and Divorce Act, § 306, <http://www.uniformdivorce.com/UMDA.pdf>.

IRC § 7703(b) also prevents separated taxpayers from being considered “not married” in two ways. First, the statute retains an outdated “cost of maintaining a household” test that disproportionately affects members of racial and ethnic minorities who work and have children.<sup>124</sup> Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year’s end. The National Taxpayer Advocate previously recommended that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.”<sup>125</sup>

### IRS Mission Statement and Administration of Family Status Provisions

The IRS has not fully embraced its role as a public benefits administrator. Presently, the roles of tax collector and benefits administrator create tension because of the differences present in agency culture, mindset, skills sets, and training. By explicitly stating the IRS’s benefits administration role as a separate agency mission in the context of service and non-coercive compliance, the IRS will be required to align its procedures, goals, and measures with those of other agencies serving similar populations.<sup>126</sup>

Toward this end, for years the National Taxpayer Advocate has recommended to the IRS that it reform its audits of EITC taxpayers (and other Family Status provisions) so that one employee is assigned to work the audit if the taxpayer calls or writes the IRS in response to the IRS audit notice.<sup>127</sup> The importance of this approach cannot be understated — family matters are some of the most personal matters a taxpayer can discuss. Thus, a single employee working the taxpayer’s case would gain familiarity with the taxpayer’s issues, be able to suggest alternate sources of documentation given that familiarity, and reassure the taxpayer who may be understandably apprehensive and anxious, incorporating some of the skills and traits associated with social workers. Such an arrangement may reduce the number of default assessments in EITC exams (where the EITC was denied because the taxpayer did not respond or stopped responding). Default assessments currently constitute over half of all assessments and are the primary type of audit closure.<sup>128</sup>

A single assigned employee is even more important where a taxpayer is *not* entitled to a Family Status benefit. An audit should result in a taxpayer being educated and knowledgeable about the rules governing the audit issues — and since EITC eligibility and family composition change so frequently (with

124 See The Ohio State University Research and Innovation Communications, *Marital Separations an Alternative to Divorce for Poor Couples* (Aug. 13, 2013), describing research by Dmitry Tumen and Zhenchao Qian, <http://researchnews.osu.edu/archive/maritalsep.htm>. This study found couples in prolonged separations tended to be racial and ethnic minorities have young children, and have low family income and education.

125 National Taxpayer Advocate 2012 Annual Report to Congress 513 (Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married”*).

126 For a detailed discussion of the need to amend the IRS Mission Statement, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

127 See generally, National Taxpayer Advocate 2014 Annual Report to Congress 134-44; National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 78; National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 63-90 (Research Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2008 Annual Report to Congress 232.

128 National Taxpayer Advocate 2015 Annual Report to Congress 252-53 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process As an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*).

one-third of the EITC population shifting each year), an ineligible taxpayer today may be an eligible taxpayer tomorrow.<sup>129</sup>

Instead of catching incorrect claims after the fact, in certain cases the IRS could rely on determinations by federal or state agencies that are already making eligibility decisions for similar public benefits. Although none of the federal or state administered benefit programs, including Temporary Assistance for Needy Families (TANF),<sup>130</sup> Supplemental Nutrition Assistance Program (SNAP),<sup>131</sup> and Section VIII housing assistance,<sup>132</sup> fully overlap with the EITC, state workers arguably have the knowledge and experience to understand the needs of low income applicants. Additionally, the state workers determining eligibility for TANF are investigating many of the same elements as EITC audits: U.S. citizenship, family structure, and household finances. In particular, because children must not be absent from the household for more than 45 days for TANF benefits, the state employees are also familiar with determining the residency of children.<sup>133</sup> This is important to consider because IRS data show that of the known errors involving qualifying children on EITC claims, 75 percent of the errors resulted from the residency test.<sup>134</sup>

The IRS Dependent Database (DDb) data show that almost 31 percent of the EITC claimants who broke a DDb rule were Title IV recipients.<sup>135</sup> It is unclear from this data whether these taxpayers received Title IV benefits with respect to the particular child claimed on the return, or for themselves or another child. But the law creates a complexity trap where the EITC definition of qualifying child differs from basic household requirements in other federal or state benefit programs. For a taxpayer, it seems irrational and incorrect for a person to receive federally funded benefits for a child from one anti-poverty program and not be eligible with respect to that same child for another anti-poverty program.

By combining the “family” component of the EITC with other Family Status provisions, resulting in a single Family Credit, refundable at lower income levels, taxpayers will be able to prove eligibility under either the Qualifying Child or the Qualifying Relative provision. Moreover, expanding the Qualifying Relative definition to include non-biological primary caregivers who are required to submit with their return a third-party affidavit(s) verifying their caregiver role and the residency requirements, will simplify the documentation process that snags so many low income taxpayers and protect against improper payments. The IRS has previously tested the use of an official IRS form whereby third parties with either personal or official knowledge of a child’s residence can so attest, under penalties of perjury. The 2005

129 In response to the National Taxpayer Advocate’s recommendations, the IRS maintains its current correspondence exam system is sufficient. It questions what would happen if a taxpayer called and the employee assigned the case is unavailable. The National Taxpayer Advocate finds this objection unconvincing. Taxpayers can be provided the option of receiving a call-back from the assigned employee, or speaking with the next available representative. Moreover, the National Taxpayer Advocate’s proposal promotes individual employee accountability in the correspondence exam program, which is sorely lacking. National Taxpayer Advocate Fiscal Year 2016 Report to Congress vol. 2, 48-51.

130 42 U.S.C. §§ 601-679c.

131 42 U.S.C. § 1786.

132 42 U.S.C. § 1437f.

133 42 U.S.C. § 608(a)(10)(A)

134 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 22 (Pub. 5162, Aug. 2014).

135 IRS Dependent Database (DDb) for processing year (PY) 2015. In particular, 1,753,285 taxpayers broke DDb rules associated with Title IV whereas 5,701,546 taxpayers broke some DDb rule.

test found the affidavit was more reliable than other forms of documentation traditionally accepted by the IRS.<sup>136</sup>

## EXPLANATION OF RECOMMENDATION

Our proposals attempt to redefine the eligibility rules for the Code's Family Status provisions in a way that allows the tax system to get to "yes" in most instances without imposing intolerable compliance burdens on taxpayers. They build on improvements accomplished with the enactment of the Uniform Definition of a Child. The proposals also incorporate and improve upon the IRS's current technology and revenue protection strategies, and establish eligibility requirements based on the IRS's ability to verify those requirements either systemically or with minimal burden to the taxpayer. They are designed to accommodate the reality of U.S. family structures while minimizing compliance risk. They also recognize that family structures are inherently complex, and some element of "good enough" is required for a program like this to be perceived as fair and just.

In making our proposals, we do not flesh out all relevant rules, nor do we take a position on the distribution of family or work benefits. We expect that Congress will hear from many sources on these very points, and indeed, there are many studies to guide one in making these decisions.<sup>137</sup> However, as Congress works through reform of these family tax provisions, it should keep in mind that in the family status area, a trade off exists between rigidity, complexity, and taxpayer burden on the one hand, and flexibility, simplicity, and taxpayer compliance on the other.

A multitude of rules that focus on the perceived abuse-of-the-day ends up creating traps and burdens for *all* taxpayers. By combining several provisions into one Family Credit, we eliminate complex and often contradictory eligibility requirements still extant in the Code today. The Family Credit includes a basic credit for the taxpayer, another credit for the taxpayer's spouse (although under our earlier proposal for repealing Joint and Several Liability,<sup>138</sup> each spouse would claim his or her own credit), and a credit for each qualified child or qualified relative. By retaining the UDOC provisions of Qualifying Child and Qualifying Relative, we bring consistency to tax reform. However, we expand the definition of Qualifying Relative by clarifying that non-relatives meet the "principal place of abode" test if the child and the taxpayer share the same home as a member of the household for more than six months of the year. Moreover, we update the archaic "decree of separate maintenance" provision in IRC § 7703(a)

136 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* (Oct. 2005). This study found that affidavits had the highest rate of acceptance at 82%, compared to an overall acceptance rate of 64% for all substantiation types (letters, documents, notarized statements). *Id.* at 33. The IRS recently published a report about a later study of residency requirement affidavits. TAS raised significant concerns about the design of this test and the first draft of the study. While we continue to have concerns, the final report has revised some of its conclusions and entered more caveats. Nevertheless, we believe the study is flawed because, unlike the 2005 study, it only tested the "accuracy" of affidavits and did not test the accuracy of other forms of documentation. Therefore, unlike the 2005 study, it cannot conclude that affidavits are more or less accurate than other forms of documentation currently accepted by the IRS. See IRS, *EITC Third-Party Affidavit Study* (Aug. 2016).

137 See, e.g., Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>; Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, TPC, <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults>; The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (November 2005); Adam Carasso, Jeffrey Rohaly, and C. Eugene Steuerle, *A Unified Children's Tax Credit*, National Tax Association Proceedings (May 15, 2005), <http://www.urban.org/uploadedPDF/1000790.pdf>; Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Sized Adjustment to the Minimum Wage*, 57 *Tax L. Rev.* 301 (Spring 2004); Max B. Sawicky, Robert Cherry and Robert Denk, *The Next Tax Reform: Advancing Benefits for Children*, Economic Policy Institute (2002).

138 See National Taxpayer Advocate 2005 Annual Report to Congress 407-32 (Key Legislative Recommendation: *Another Marriage Penalty: Taxing the Wrong Spouse*).

by including a written separation agreement by year end as proof of being “not married.” We modify the “principal place of abode” rule under IRC § 7703(b) to require only “more than six months” of cohabitation with the qualifying child or relative, so that families like that headed by Ms. Cowan can receive the benefit of Family Status provisions.

We reduce burdens associated with the residency requirement by requiring the IRS to publish and accept an affidavit form on which third parties can certify periods of residence. Similarly, the IRS would be authorized to develop data-matching applications for Title IV and Title VIII benefits, and accept a proxy for the residency and relationship tests and public agency certifications that a taxpayer received public benefits with respect to a child for more than half the year.

Because there is no cap on the number of children who can be claimed by a taxpayer and the Family Credit is refundable at lower income levels but also available to taxpayers with higher incomes, taxpayers will not find themselves having to “lend” or “borrow” children. Where there are no “dueling” claims for children, the IRS will pay out the Qualifying Child or Qualifying Relative component of the credit so long as the IRS verifies that the child exists and is of the requisite age (via the Social Security database). Where there are competing claims, Congress can refine the current EITC tie-breaker rules to address these concerns.

The new credit for noncustodial parents who pay their entire child support obligations for the calendar year addresses the fundamental concept of taxing persons based on their ability to pay. The credit will also reduce many of the current competing claims for dependency exemptions, child credit, head of household filing status, and EITC.<sup>139</sup> Taxpayers can demonstrate child support payment compliance through affidavits from the payee or from the appropriate child support enforcement agency.

Repeal of head of household filing status eliminates some tax benefits for persons maintaining a home for parents or other persons who are not the taxpayer’s child. Thus, we propose to allocate some of the tax benefits associated with head of household filing status to the proposed add-on credit for dependent care, which would be available to taxpayers who provide primary care for members of their extended family either inside or outside of their homes.

Taxpayers will be eligible for the modified EITC on a per-worker basis. Expanding the age eligibility will extend important work incentives and income supplements to currently underserved populations. Clarifying the IRS’s authority to adjust a return and issue a refund where the income data demonstrates the taxpayer is eligible will ensure an almost 100 percent participation rate for this important program. Moreover, because the presence or absence of a child is not an eligibility factor, the IRS can check eligibility on the basis of income reporting in real time during the filing season, given the accelerated reporting of Forms W-2 and 1099-MISC (NEC). The proposal retains the refund issuance date of February 15 as a compliance mechanism.<sup>140</sup>

139 For processing year 2016, 69.7 percent of the returns which had a DDb duplicate dependent rule break had the relationship for all children established. Another 8.9 percent of the taxpayers had the relationship for some children established. Data is from a Business Object interface with the DDb, showing returns claiming EITC scored by the DDb for processing year 2015, which generally corresponds to returns filed for tax year (TY) 2014. By recognizing the child support contribution of noncustodial parents through the proposed add-on credit, we reduce the incentive to file duplicate claims.

140 For a recommendation that the Department of Treasury utilize the Direct Express debit card and payroll debit cards as low-cost electronic refund delivery options, see Most Serious Problem: *Payment Cards: Payment Cards Are Viable Options for Refund Delivery to the Unbanked and Underbanked, But Security Concerns Need to Be Addressed, supra.*

The proposed per-person EITC retains its purpose of incentivizing work for low and middle income taxpayers and minimizing the regressivity of the Social Security payroll tax. Similarly, the Family Credit reflects an acknowledgment of the minimum cost of basic living expenses by household size. Thus, the National Taxpayer Advocate recommends that Congress consider limiting the offset provisions under IRC § 6402 to 25 percent of the overpayment attributable to the refundable EITC as well as the refundable Family Credit.<sup>141</sup>

The net effect of these proposals is to take the IRS out of the business of looking intrusively into taxpayers' family situations. The tax provisions relating to family status will be subject to common sense rules that recognize the variety of family circumstances in the United States. While there are winners and losers (as with all reform proposals), these proposals eliminate conflicting, counter-intuitive eligibility rules (thereby converting currently noncompliant taxpayers into compliant ones), remove the IRS from custody and divorce contests, and focus much of its compliance work in this area on data that can be verified through third-party reporting, other government and private databases, and in a relatively few instances, from the taxpayer him or herself, with a minimum of taxpayer burden.

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141 For processing year 2015, 1,308,146 (4.8%) refunds associated with returns claiming EITC were offset against other IRS tax liabilities.



## APPENDIX A

FIGURE 2.1.5, Costs and Benefits of Federal Payment Programs

| Program   | SNAP       | WIC        | SSI           | TANF          | HUD        | CHIP          | Medicaid      | School Lunch | EITC       |
|---|------------|------------|---------------|---------------|------------|---------------|---------------|--------------|------------|
| Year  | FY 2013    | FY 2010    | FY 2012       | FY 2011       | FY 2013    | FY 2012       | FY 2013       | FY 2013      | FY 2014    |
| Number of Recipients  | 47.6 mil   | 9.1 mil    | 8.3 mil       | 4.6 mil       | 4.7 mil    | 8.1 mil       | 55.0 mil      | 30.7 mil     | 27.8 mil   |
| Number of Eligible Persons                                  | 51.9 mil   | 14.6 mil   | 13.0-14.3 mil | 12.2-14.4 mil | 9.1 mil    | 11.8-12.2 mil | 76.0-80.6 mil | 49.2 mil     | 22.7 mil   |
| Participation Rate (# of Recipients/ # of Eligible Persons) | 79.0%      | 62.6%      | 58.0%         | 32.0%         | 49.3-51.5% | 66.9 - 68.8%  | 68.2%         | 54.3-64.3%   | 78.8%      |
| Year Participation Rate Measured                            | FY 2011    | CY 2010    | 1998          | 2009          | 2013       | FY 2012       | 2009          | 2012         | TY 2009    |
| Total Benefits Paid Out                                     | \$76.1 bil | \$4.6 bil  | \$51.1 bil    | \$15.2 bil    | \$30.9 bil | \$8.5 bil     | \$248.3 bil   | \$11.3 bil   | \$60.3 bil |
| Average Benefit per Recipient                               | \$133.07   | \$500.86   | \$6,156.54    | \$3,300.84    | \$6,574.47 | \$1,047.64    | \$4,514.55    | \$368.39     | \$2,384.32 |
| Overhead Costs  | \$3.9 bil  | \$1.9 bil  | \$3.8 bil     | \$1.5 bil     | \$4.3 bil  | \$3.1 bil     | \$11.7 bil    | \$1.2 bil    | \$0.6 bil  |
| Overhead Costs as % of Total Benefits Paid Out              | 5.1%       | 41.8%      | 7.4%          | 9.7%          | 13.8%      | 36.3%         | 4.7%          | 10.3%        | 1.0%       |
| Improper Payments   | \$2.6 bil  | \$0.04 bil | \$4.7 bil     | \$2.3 bil     | \$1.3 bil  | \$0.7 bil     | \$14.4 bil    | \$1.8 bil    | \$14.5 bil |
| Improper Payments as a % of Total Benefits Paid             | 3.4%       | 1.0%       | 9.2%          | 15.0%         | 4.3%       | 8.2%          | 5.8%          | 15.7%        | 24.0%      |
| Overhead Costs + Improper Payments                          | \$6.5 bil  | \$1.9 bil  | \$8.5 bil     | \$3.8 bil     | \$5.6 bil  | \$3.8 bil     | \$26.1 bil    | \$3.0 bil    | \$15.1 bil |
| Overhead Costs + Improper Payments as a % of Total          | 8.5%       | 42.8%      | 16.6%         | 24.7%         | 18.1%      | 44.5%         | 10.5%         | 26.0%        | 25.0%      |

## End Notes for Cost and Benefits of Federal Payment Programs

### SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP)

The number of recipients, benefits paid, average benefit, and overhead costs are from *Supplemental Nutrition Assistance Program Participation and Costs* (March 6, 2015). The number of improper payments and their percent of benefits paid are from <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The participation rate is from *Supplemental Nutrition Assistance Program Participation Rates: Fiscal Years 2010 and 2011* (Feb. 2014).

### WOMEN, INFANTS, AND CHILDREN (WIC)

WIC recipients, eligible, and participation rate are from *Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) Eligibles and Coverage – 2010: National and State Level Estimates of the Population of Women, Infants, and Children Eligible for WIC Benefits Executive Summary* (Jan. 2013). Benefits are from: WIC Program Food Cost (March 6, 2015). Overhead costs are from: *WIC Program: Nutrition Service and Administrative Costs* (March 6, 2015). Improper payments: *Nutritional Assistance Program Report Series, Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). Erroneous Payments to Vendors: Annual Estimates for FY 2010 Office of Research and Analysis Report No. WIC-12-EP2010WIC*.

### TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF)

The recipients, overhead costs (includes administration and systems costs), and participation rate are taken from U.S. Department of Health and Human Services, Administration for Children and Families Office of Family Assistance, *Temporary Assistance for Needy Families Program (TANF) Tenth Report to Congress*. The benefits are from the report to Congress, Appendix Table 1:1. HHS has not estimated TANF improper payments because the program is administered by the various states that distribute federal funds and the states have not performed improper payment reviews. The improper payment rate shown has been estimated by the *Federal Safety Net*, available at: <http://federalsafetynet.com/tanf.html>. HHS claims there is a statutory prohibition against requiring states to report improper payments. In 2007, HHS did a study in three states with the improper payment rate ranging from 11.5 percent to 40 percent. The 15 percent estimate is from a private source (Federal Safety Net). The participation rate is based on families, not individuals. Overhead costs do not include other expenditures on non-assistance, which are defined as, “benefits are those that do not fall within the definition of assistance, and include expenditures such as child care, transportation, and other work supports provided to employed families, non-recurrent short-term benefits, work subsidies to employers, and services such as education and training, case management, job search, and counseling.” The administrative expenses portion of non-assistance was tabulated as the overhead expense of the program.

### SUPPLEMENTAL SECURITY INCOME (SSI)

Recipients are from *Table IV.B9.—SSI Recipients with Federally-Administered Benefits in Current-Payment Status as of December, 1974-2036*. The benefits are imputed from the FY 2012 improper payments and improper payment rates at <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The participation rate is from Kathleen McGarry, University of California, Los Angeles and NBER, and Robert F. Schoeni University of Michigan, *Understanding Participation in SSI*, Prepared for the 16th Annual Joint Meeting of the Retirement Research Consortium (Aug. 7–8, 2014). The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants

are assumed eligible and are thus divided by the participation rate to form the upper bound. Overhead costs are from the Social Security Administration's 2012 Annual Report of the SSI Program Table IV.E1., available at [http://www.ssa.gov/OACT/ssir/SSI12/IV\\_E\\_AdminCosts.html](http://www.ssa.gov/OACT/ssir/SSI12/IV_E_AdminCosts.html).

#### DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

The number of recipients (households) is taken from HUD, *Rental Assistance Reform Frequently Asked Questions* (Mar. 2013). The total benefits are from improper payments and improper payment rate for FY 2013 from the federal government's improper payment website, <https://paymentaccuracy.gov/about-improper-payments>. The overhead costs are from the National Health Care for the Homeless Council compilation of items in the *Enacted Funding Levels FY2011–FY2013* (Mar. 2013). The number of households in poverty is used as a benchmark to compute the participation rate; however, the actual formula to compute eligible families involves the determination of average income and housing prices on a county-by-county basis. The number of 2013 households in poverty is from a U.S. Census Bureau Current Population Survey report, Carmen DeNavas-Walt and Bernadette D. Proctor, *Income and Poverty in the United States: 2013* (Nov. 2014). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Therefore, this is only an estimated participation rate range.

#### CHILDREN'S HEALTH INSURANCE PROGRAM (CHIP)

The total benefits are imputed from improper payments and improper payment rate for FY 2012 from the federal government's improper payment web site, <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The recipients and participation rate are taken from "CHIPRA Mandated Evaluation of the Children's Health Insurance Program: Final Findings Harrington and Kenney, *et al.* 2014 ..." Mathematica Policy Research, report submitted to the Office of the Assistant Secretary for Planning and Evaluation. Ann Arbor, MI (Aug. 2014). This report shows benefits paid as \$9.2 billion instead of the \$9.1 billion imputed from the federal improper payment website. All participants are assumed eligible and are thus divided by the sum 48 of the participants and the number of children eligible, but still uninsured (3.7 million: see *CHIPRA Mandated Evaluation* report cited above) to form the upper bound estimate of the participation rate. The lower bound participation rate estimate reduces the number of participants by the quotient obtained from dividing improper payments by the average benefit to obtain the average number of ineligible participants and the result is divided by the estimated eligible participants and the number of eligible, but uninsured children. The range of eligibles is computed at the lower bound by dividing the number of participants by the sum of the number of participants and the number of eligible, but uninsured children (see above). At the upper bound, the number of participants is reduced by the quantity of the dividing improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the lowest estimated participation rate. The Overhead Costs are taken from *Medicaid Financial Management Report net CHIP Expenditures FY 2012* and include the National Health Insurance Technology (HIT). The HIT costs for FY 2012 were divided by the FY 2012 imputed benefits.

#### MEDICAID

The numbers of recipients is from the Kaiser Family Foundation, *Medicaid Enrollment: June 2013 Data Snapshot*, <http://kff.org/report-section/medicaid-enrollment-june-2013-data-snapshot-total-enrollment>. The paper goes on to state that Medicaid enrollment is expected to increase as a result of the Affordable

Care Act. In fact, Medicaid enrollment has increased to over 60 million in 2014, according to *Medicaid/CHIP Participation Among Children and Parents*, Medicaid / CHIP FY 2014 September enrollment data, with the number of CHIP participants subtracted from the total. The participation rate is from the highest recent rate cited in *Understanding Participation Rates in Medicaid: Implications for the Affordable Care Act*: Ben Sommers, Rick Kronick, Kenneth Finegold, Rosa Po, Karyn Schwartz, and Sherry Glied (Mar. 2012), <http://aspe.hhs.gov/health/reports/2012/MedicaidTakeup/ib.shtml>. The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants are assumed eligible and are thus divided by the participation rate to form the upper bound. The improper payments, total benefits paid, and improper payment rate are from the Federal government website: <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The overhead costs are from *Medicaid's National Health Expenditures* administrative costs for FY 2013.

#### SCHOOL LUNCH PROGRAM

The recipients are from *National School Lunch Program: Total Participation* (FY 2013). The total benefits, improper payments, and improper payment rate for FY 2013 are from the federal government's improper payment website: <https://paymentaccuracy.gov/about-improper-payments>. The amount of improper payments and the improper payment rate also come from this source. There is a slight discrepancy between the amount of imputed payments and the amount in a 2014 GAO report (\$0.1 billion difference). The eligibles are determined from the National Center for Educational Statistics, Table 216.60 *Number and Percentage of public school students eligible for free or reduced price lunch by school level, locale and student race/ ethnicity 2011-12*, [https://nces.ed.gov/programs/digest/d13/tables/dt13\\_216.60.asp](https://nces.ed.gov/programs/digest/d13/tables/dt13_216.60.asp) (last visited April 9, 2015). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Census data indicate more children may receive free lunches than are entitled to do so, but this should be reflected in improper payments. Overhead costs are determined from the Federal Register's *National School Lunch Program: School Food Service Accounts Revenue Amendments Related to the Healthy-Hungry Free Kids Act* (2010), <https://www.federalregister.gov/articles/2011/06/17/2011-14926/national-school-lunch-program-school-food-service-account-revenue-amendments-related-to-the-healthy-hungry-free-kids-act>. The report is from school year 2005 and 2006 and reports a percentage only. The percentage is applied to the benefits paid in FY 2013.

#### EARNED INCOME TAX CREDIT (EITC)

The number of EITC recipients is from IRS Compliance Data Warehouse, *Individual Returns Transaction File for Tax Year 2013*. The benefits are from the FY 2014 improper payments and improper payment rates at <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The amount of improper payments and the rate of improper payments are also from this source. The EITC participation rate and number of eligibles is from the CARRA Working Paper Series, *Working Paper #2014-04 Changes in EITC Eligibility and Participation, 2005-2009*, Maggie R. Jones, U. S. Census Bureau Center for Administrative Records Research and Applications (2009), <http://www.eitc.irs.gov/EITC-Central/Participation-Rate>. This site only provides the percent eligible. The overhead costs are from GAO testimony, GAO/T-GGD-97-105, *Tax Administration Earned Income Noncompliance* (May 8, 1997).

LR  
#3**OUTSIDE RESEARCH: Expand Opportunities for the IRS to Collaborate With Outside Researchers****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

Private sector and academic researchers can help policymakers improve tax administration and achieve public policy goals by studying microdata (*i.e.*, tax data that is not aggregated into summary statistics).<sup>2</sup> Some are willing to provide cutting-edge research for free. Collaboration with outsiders can also help IRS researchers learn about the latest data analysis techniques. To collaborate, however, the IRS typically must evaluate proposals, help the outsider identify and understand the data, oversee the project, and implement measures to protect the data from unauthorized disclosure.<sup>3</sup> Because of the resources this requires, the IRS is not able to accept otherwise worthy proposals. Moreover, uncertainty about whether the IRS will accept good proposals combined with the burden and delay of obtaining microdata likely discourages some outsiders from offering to collaborate.

Finally, the IRS might naturally focus on proposals that fulfill immediate, short-term needs, or that are likely to validate its longstanding views. However, short-term priorities should not crowd out research into unconventional, innovative, and paradigm shifting ideas that are more likely to advance our understanding of taxpayers and their compliance behavior. Unlike other agencies, the IRS does not use an external peer review process to help ensure that it considers the best proposals.

**EXAMPLE**

University Professor X and her graduate student are interested in using IRS microdata to identify ways to use behavioral science insights to improve compliance with a particular tax provision and to achieve public policy goals. The graduate student would like to pursue the research as part of a dissertation. IRS researchers could learn a lot from Professor X's state-of-the-art research techniques.

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See, e.g., Shamik Trivedi, *Increased Microdata Accessibility Will Aid Policymakers*, 2012 TNT 34-4 (Feb. 21, 2012) ("The research conducted from microdata can address a variety of concerns. Research into behavioral responses to specific policies could contribute significantly to structural tax reform, help determine the effects of changing the level and graduation of individual and corporate tax rates and of broadening the individual tax base, help measure compliance, and help inform the use of taxes to address a fiscal imbalance.").

3 Statistics of Income (SOI) response to TAS information request (July 7, 2016). For example, the IRS may have to administer contracts with the researchers, conduct background checks, and obtain office space, equipment, software, and technical support for the researchers.

However, it could take more than two years to gain access to the data, as the IRS only solicits proposals under the Joint Statistical Research Program (JSRP) about every two years during a narrow (60-day) window.<sup>4</sup> X's student would like to graduate within two years. Even after two years, the IRS may decline the project because it does not accept every good proposal. X believes the IRS has other short-term research priorities, despite the fact that this research may point to more effective methods of achieving compliance. Thus, X and her student pursue other research because of the burden and delay of gaining access to IRS microdata and uncertainty about whether the IRS would be interested in the project.

## RECOMMENDATIONS

To ensure the IRS has the capacity to accept valuable assistance from outside researchers, and to ensure IRS data is available for studies involving a wide variety of issues, disciplines, and approaches, the National Taxpayer Advocate recommends that Congress:

- (1) Establish an independent Tax Research Review Board (TRRB) to vet and prioritize research proposed by outsiders to ensure that the government pursues important research questions that the IRS might not otherwise pursue; and
- (2) Establish and fund an independent technical staff to support both the TRRB in evaluating proposals and the outside researchers in conducting the research.

## PRESENT LAW

### Collaboration Requires Resources, Even If the Researchers Are Uncompensated

It is costly for both the IRS and outside researchers to keep microdata confidential. Virtually any information about a taxpayer or his or her return, including the existence of the return, is confidential “return information” under Internal Revenue Code (IRC) § 6103(b)(2), unless it is in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.<sup>5</sup> IRC § 6103(a) generally prohibits the improper disclosure of return information by IRS employees and others (including outside researchers).<sup>6</sup> Unauthorized inspection or disclosure of such information may be punishable by fine or imprisonment, and in the case of federal officers or employees, dismissal from office or employment.<sup>7</sup> In addition, IRC § 7431 provides for civil damages for unauthorized disclosures.

The IRS is authorized to grant outside researchers access to the microdata needed to conduct research under the Intergovernmental Personnel Act, 5 U.S.C. § 3371 *et seq.*, the Student Volunteer program, 5 U.S.C. § 3111(c), or a contract executed under IRC § 6103(n). The IRS could also grant them access as temporary IRS employees under 5 U.S.C. § 3109, but it generally does not use this authority.<sup>8</sup> Other government agencies, such as the Census Bureau, are also authorized to receive IRS microdata for specific purposes under IRC § 6103(j)(1)(A).

To comply with privacy rules, the IRS must oversee each project and provide the outside researchers with limited data extracts when broader access is unnecessary.<sup>9</sup> The outside researchers must pass a background

4 SOI response to TAS information request (May 31, 2016) (SOI Joint Research Program Description).

5 IRC § 6103(b)(2). “Macro” data cannot be associated with or otherwise identify a particular taxpayer, but “micro” data can, unless it is redacted or “perturbed” (*i.e.*, changed to obscure identifying information).

6 See also IRC § 6108(c).

7 See IRC § 7213; IRC § 7213A; 18 U.S.C. § 1905 (the Privacy Act).

8 IRS response to TAS information request (July 7, 2016).

9 *Id.*



check and take annual training on data security.<sup>10</sup> They must also employ the IRS's procedural safeguards to protect the information from disclosure, as required under IRC § 6103(p)(4).<sup>11</sup>

Although permanent IRS employees may access taxpayer information on IRS equipment from home, the IRS typically does not grant remote access to outside researchers.<sup>12</sup> They generally must work with the data in an approved IRS facility using IRS equipment.<sup>13</sup> Thus, the IRS is likely to receive proposals primarily from researchers located near an IRS facility, limiting its opportunity to collaborate with a significant number of highly qualified researchers in the U.S. and abroad.

In some cases, however, outside researchers may be able to access a limited amount of data at locations outside the IRS. For example, the IRS may provide microdata to the Census Bureau “to the extent necessary in, the structuring of censuses and national economic accounts and conducting related statistical activities authorized by law” under IRC § 6103(j)(1)(A). Thus, it may be possible for outside researchers to access this data at the Census's Center for Economic Studies (CES) or at local Research Data Centers (RDCs).<sup>14</sup> There are currently 24 RDC locations that partner with over 50 research institutions.<sup>15</sup> Researchers can access this data by becoming temporary Special Sworn Employees (SSEs) of the Census.<sup>16</sup> However, only a subset of the IRS's microdata is available through the Census.<sup>17</sup> Moreover, outside researchers often need to collaborate with IRS employees to understand what the data represents and merge it with other relevant data from various IRS databases. Thus, to facilitate outside research, the IRS generally must provide an IRS research partner who has compatible expertise, as well as technical support, office space, and equipment.

### Uncertainty and Delay May Discourage Some From Offering to Collaborate

The IRS solicits offers to collaborate on research through its Joint Statistical Research Program (JSRP). Under the JSRP, an outside researcher must submit a proposal with well-defined goals that aligns with the IRS's research priorities.<sup>18</sup> The IRS only accepts proposals within a 60-day window that opens about every two years. The IRS's Statistics of Income Division (SOI) develops the IRS's research priorities in coordination with directors of the IRS's Research, Applied Analytics, and Statistics (RAAS) function and

10 IRS response to TAS information request (June 3, 2016).

11 See, e.g., IRS Publication 1075, *Tax Information Security Guidelines for Federal, State and Local Agencies* (2015). Similarly, other parts of the federal government may provide contractors with access to confidential information, provided their systems and access procedures comply with the Federal Information Security Management Act of 2002. See 44 U.S.C. § 3541, et seq.

12 IRS response to TAS information request (June 3, 2016) (“There are no legal barriers that prevent researchers who have undergone background checks and obtained PIV cards from accessing IRS data remotely using ... IRS equipment. RAS has maintained a policy of requiring researchers to work in an IRS facility to ensure maximum protection for IRS data. Of particular concern is disclosure by proximity – for example ... having a student inadvertently view the screen. In addition, we believe that working in an IRS facility heightens the researchers' awareness of data security. IRS does not currently permit users to access data systems using personal devices and employees are forbidden to use personal computer for work by law.”).

13 IRS response to TAS information request (June 3, 2016).

14 We understand National Center for Health Statistics (NCHS) allows researchers to access confidential micro data using four different modes: (1) on-site at the NCHS Research Development Center (RDC), (2) on-site at a Census RDC, (3) remote access, and (4) staff assisted research. See John Czajka et al., *Minimizing Disclosure Risk in HHS Open Data Initiatives*, MATHEMATICA D-25 (2014), [https://aspe.hhs.gov/sites/default/files/pdf/77196/rpt\\_Disclosure.pdf](https://aspe.hhs.gov/sites/default/files/pdf/77196/rpt_Disclosure.pdf).

15 U.S. Census Bureau, *Research Data Centers*, <http://www.census.gov/about/adrm/fsrdc/locations.html> (last visited Oct. 31, 2016).

16 Agreement for the Review and Approval of U.S. Census Bureau Projects that use Federal Tax Information (June 2012), [https://www.census.gov/ces/pdf/IRS\\_Criteria\\_Document.pdf](https://www.census.gov/ces/pdf/IRS_Criteria_Document.pdf).

17 See Treas. Reg. § 301.6103(j)(1)-1(b).

18 The information in this section is from SOI. SOI response to TAS information request (May 31, 2016) (SOI Joint Research Program Description).

the Department of Treasury Office of Tax Analysis (OTA), but allows applicants to propose additional ideas. RAAS and OTA evaluate the proposals based on factors such as:

- Relevance to tax policy and/or tax administration, with preference given to projects with a direct impact on current tax policy questions;
- Available SOI resources, including data, human capital, and financial resources;
- Degree of SOI employee involvement required by the proposal;
- Importance of the issue to the IRS and OTA; and
- Research team's demonstrated ability to do the work, based on past performance, qualifications, etc.

The IRS does not ask experts outside the agency to help review the proposals. The length of time between solicitations, the uncertainty about whether proposals are likely to be accepted (given the government's sole control over evaluation and decisions), the short period during which they will be considered, and the delay in getting started after acceptance could discourage outsiders from offering to collaborate.

### External Peer Review Helps Other Agencies Evaluate Research Proposals

Other agencies that fund research such as the National Institutes of Health (NIH), the National Science Foundation (NSF), the Environmental Protection Agency (EPA), and the National Endowments for the Arts and Humanities (NEH) have long used peer-review systems to assess grant applications.<sup>19</sup> The NIH maintains over 150 chartered federal advisory committees to assist with these reviews.<sup>20</sup> NIH generally only funds proposals reviewed and recommended by two peer review groups, which consist primarily of external reviewers.<sup>21</sup> These groups help assess the likely impact and merit of the proposed research. As a result, NIH is more likely to fund proposals that representatives from both the public and private sector have identified as being the most fruitful and meaningful areas of study.

## REASONS FOR CHANGE

Policymakers inside and outside the IRS can benefit from the cutting-edge expertise that outside researchers can offer. Outside researchers cannot be as effective without access to government microdata. The U.S. generally lags behind other countries in making microdata available to researchers who want to help.<sup>22</sup> Limited IRS resources constrain its ability to provide outside researchers with access to microdata.

19 Thomas McGarity, *Peer Review in Awarding Federal Grants in the Arts and Sciences*, 9 HIGH TECH. L.J. 1 (1994), <http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1115&context=btlj>; General Accounting Office, *Federal Research: Peer Review Practices at Federal Agencies Vary*, GAO/RCED-99-99 1-2, 6-7 (Mar. 1999), [www.gao.gov/products/GAO/RCED-99-99](http://www.gao.gov/products/GAO/RCED-99-99) (discussing the peer review processes used by 12 agencies that accounted for 90 percent of the government's research budget, excluding the Department of Defense).

20 National Institutes of Health (NIH), *Overview of Federal Advisory Committees at the NIH*, [https://ofacp.od.nih.gov/about\\_us/overview.asp](https://ofacp.od.nih.gov/about_us/overview.asp) (last visited Nov. 2, 2016).

21 42 U.S.C. § 289 *et seq.*; 42 C.F.R. § 52h. For additional detail, see NIH Office of Extramural Research, *Peer Review Process*, [http://grants.nih.gov/grants/peer\\_review\\_process.htm#Overview](http://grants.nih.gov/grants/peer_review_process.htm#Overview) (last visited Nov. 2, 2016). Other research agencies have similar procedures. See, e.g., Center for Disease Control, CDC-GA-2002-09, *Peer Review of Research and Scientific Programs* (Sept. 3, 2008), <https://www.cdc.gov/maso/pdf/PeerReview.pdf>.

22 David Card *et al.*, *Expanding Access to Administrative Data for Research in the United States*, National Science Foundation 10-069 call for white papers (2012), <https://eml.berkeley.edu/~saez/card-chetty-feldstein-saezNSF10dataaccess.pdf> ("During the second half of the 20th century, the fields of political science, sociology, and economics were all revolutionized by U.S. researchers using U.S.-based survey data sources. Unfortunately, that dominant position is now at risk as the research frontier moves to the use of administrative data.").

As a result, the IRS can only accept a limited number of proposals. It only accepts them during a 60-day window every two years or so.<sup>23</sup> These delays may discourage some good proposals.

In addition, the IRS has its own research agenda and may not always agree that important projects are worth pursuing, even though it consults with external stakeholders when forming its agenda. For example, Congress and the President have encouraged the IRS to pursue research into behavioral insights and test alternative treatments, which it is pursuing.<sup>24</sup> However, because no IRS business unit is accountable for implementing alternative treatments (*i.e.*, alternatives to enforcement) or measuring and reporting the resulting “service” revenues, each of its business units may prefer enforcement-oriented research,<sup>25</sup> which they may view as more relevant to their core functions. The IRS and OTA may have other biases that they do not recognize.

## EXPLANATION OF RECOMMENDATIONS

Congress should establish an independent Tax Research Review Board (TRRB) with a staff that could help it set research priorities and fully support collaboration with outside researchers. The TRRB could be comprised of external researchers such as those from think tanks and academia, as well as representatives from the IRS, TAS, and OTA. As some of its members would not be government employees, the TRRB could be established as a federal advisory committee that would make recommendations to the IRS. Such a committee would be subject to the Federal Advisory Committee Act (FACA), which requires, among other things, that certain meetings be announced in the Federal Register and open to the public.<sup>26</sup> Alternatively, the TRRB could be a given operational responsibility to select which proposals to accept, in which case it would not necessarily be subject to the FACA.<sup>27</sup> The IRS Oversight Board is an operational committee.<sup>28</sup> It or one or more of its subcommittees could be assigned to function as the TRRB.

By having both outsiders and government employees as members, the TRRB would help the government pursue research that the IRS wants to pursue, as well as innovative research in other areas that it should be pursuing. The TRRB could conduct literature reviews as well as surveys and focus groups of potential submitters to learn what they are interested in and to develop a better sense of the possibilities. It could be required to publish the results of its reviews, surveys, focus groups, and analyses to assure outsiders

23 SOI response to TAS information request (May 31, 2016) (SOI Joint Research Program Description).

24 See, e.g., Exec. Order No. 13707, 80 Fed. Reg. 56365 (Sept. 18, 2015).

25 See, e.g., Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*; Most Serious Problem: *IRS Structure: The IRS’s Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *supra*.

26 See Federal Advisory Committee Act (FACA), Pub. L. No. 92-463, 86 Stat. 770 (1972) (codified as amended at 5 U.S.C. App. II §§ 1-16).

27 41 C.F.R. § 102-3.40(k) (“Operational functions are those specifically authorized by statute or Presidential directive, such as making or implementing Government decisions or policy. A committee designated operational may be covered by the Act if it becomes primarily advisory in nature. It is the responsibility of the administering agency to determine whether a committee is primarily operational. If so, it does not fall under the requirements of the Act and this part.”).

28 The Oversight Board is a nine-member independent body charged with operational responsibility to oversee the IRS. IRC § 7802. Seven board members are appointed by the President of the United States and confirmed by the Senate for five-year terms. *Id.* Of the seven, one must be a full-time federal employee or a representative of IRS employees. *Id.* The Secretary of Treasury and the Commissioner of Internal Revenue are also members of the Board. *Id.* The board currently has too many vacancies to operate. IRS Oversight Board, <https://www.treasury.gov/IRSOB/Pages/default.aspx> (last visited Dec. 13, 2016).

that it is open to all good suggestions and can be persuaded to pursue new research areas in the future. Transparency would also help prevent the TRRB from being unduly influenced by commercial interests.<sup>29</sup>

To ensure the TRRB's independence from the IRS, it should have sufficient public funding so that it does not need to rely on the IRS to fund the selection or collaboration processes. The TRRB's staff could have expertise in disclosure, procurement, and IRS research and databases, so that it could support both the TRRB and the outside researchers whose proposals are selected. The staff could also be available to discuss how to improve prospective proposals.

With a stable source of funding, independent from the IRS, the TRRB could solicit tax research proposals more often (perhaps even on a rolling basis), and avoid rejecting meritorious proposals due to a lack of resources or short-term focus. Congress should also consider where to place the TRRB's staff. To foster independence, the staff could be lodged in an independent organization at the IRS or at the Department of Treasury.<sup>30</sup>

Both IRS researchers and TRRB staff would have overlapping skills. These skills would enable IRS researchers to work at the TRRB on temporary details. Such details would enable the IRS's research staff to continue to benefit from working with outside researchers.

29 Some have suggested the FACA makes the peer review process overly cumbersome. See, e.g., Gregory Morrison, *Science in the Modern Administrative State: Examining Peer Review Panels and the Federal Advisory Committee Act*, 82 GEORGE WASH. L. REV. 1654, at 1655-73 (2014). Indeed, the National Academy of Sciences (NAS) peer review process is exempt from the FACA. See 5 U.S.C. app. 2 § 3(2); 41 C.F.R. § 102-3.180 et seq. The NAS is still required to ensure membership is fairly balanced, that members are free from conflicts of interest, and make its reports public, including the names of peer reviewers. 5 U.S.C. app. 2 § 15.

30 If they were lodged in another department, such as the Census Bureau, then the TRRB's staff would not have direct access to IRS employees, data, or databases unless Congress amended the confidentiality rules under IRC § 6103.

LR  
#4**COLLECTION DUE PROCESS (CDP): Amend Internal Revenue Code § 6330 to Provide That the Standard and Scope of Tax Court Review in CDP Cases Is *De Novo* Regardless of Whether the Underlying Liability Is at Issue****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

Two related concepts affect how courts evaluate the correctness of an IRS action or determination: scope of review and standard of review. “The *scope* of judicial review refers to the *evidence* the reviewing court will examine in reviewing an agency decision. The *standard* of judicial review refers to *how* the reviewing court will examine that evidence.”<sup>2</sup>

When the *scope* of review is *de novo*, a court reviewing an IRS determination does not limit its consideration to evidence already contained in the IRS’s administrative record, but engages in independent fact-finding and may receive into evidence testimony and exhibits that were not included in the administrative record.<sup>3</sup> The alternative arrangement, sometimes referred to as the “record” rule, requires the reviewing court to base its judgment only on evidence already contained in the IRS’s administrative record. When the *standard* of review is *de novo*, the reviewing court considers the evidence before it anew, without deference to the IRS’s determination.<sup>4</sup> When the standard of review is for abuse of discretion, the court overturns the IRS’s determination only where it is shown to be arbitrary, capricious, or without sound basis in fact.<sup>5</sup>

Since 1924, when review of a taxpayer’s pre-payment challenge to the validity of a proposed *assessment* first became available, the scope and standard of judicial review has been *de novo*.<sup>6</sup> Since 1998, when review of a taxpayer’s pre-payment challenge to proposed *collection* of an assessed tax became available pursuant to the IRS Restructuring and Reform Act of 1998 (RRA 98), the nature of judicial review has depended on whether the underlying tax liability is at issue.<sup>7</sup> In collection due process (CDP) cases, if the underlying tax liability is at issue, the scope and standard of judicial review is *de novo*.<sup>8</sup> If the underlying

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 *Franklin Sav. Ass’n v. Office of Thrift Supervision*, 934 F.2d 1127, 1136 (10th Cir. 1991) (emphasis added).

3 *Robinette v. Comm’r*, 123 T.C. 85, 95 (2004), *rev’d* 439 F.3d 455 (8th Cir. 2006).

4 *Porter v. Comm’r*, 132 T.C. 203 (2009).

5 *Jonson v. Comm’r*, 118 T.C. 106, 125 (2002), *aff’d* 353 F.3d 1181 (10th Cir. 2003).

6 See *Appeal of Barry*, 1 B.T.A. 156 (1924); *Greenberg’s Express, Inc. v. Comm’r*, 62 T.C. 324 (1974).

7 Pub. L. 105-206, § 3401, 112 Stat. 685, 746, enacting IRC §§ 6320 and 6330, discussed below.

8 H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998).

liability is not at issue, the *standard* of review is for abuse of discretion.<sup>9</sup> As discussed below, this standard of review places an unnecessary burden on taxpayers, for whom the event of *collecting* the tax is at least as important as the previous determination to *assess* additional tax.

The courts do not agree as to the appropriate *scope* of review in CDP cases when the underlying tax is not at issue. In *Robinette v. Commissioner*, the Tax Court held that where the underlying liability is not at issue the scope of its review is *de novo*.<sup>10</sup> Thus, the court considered evidence introduced at trial that was not part of the administrative record. The Court of Appeals for the Eighth Circuit reversed the Tax Court's decision, holding that the Tax Court's review in *Robinette* was limited to the administrative record.<sup>11</sup> The Courts of Appeal for the First and Ninth Circuits agree with the Eighth Circuit, as does the IRS Office of Chief Counsel.<sup>12</sup> The Tax Court continues to adhere to its position, however, except in cases appealable to the First, Eighth, and Ninth Circuit Courts of Appeal.<sup>13</sup>

Restricting judicial review to the administrative record in CDP cases harms taxpayers, especially those who cannot afford representation or assistance during administrative proceedings. The divergence in the courts with respect to the appropriate scope of review when the underlying tax is not at issue creates uncertainty for taxpayers and consumes administrative and judicial resources. Therefore, the National Taxpayer Advocate recommends that Congress amend Internal Revenue Code (IRC) § 6330 to provide that the scope and standard of review in CDP cases is *de novo* whether or not the underlying tax liability is at issue.

## EXAMPLE 1

In response to a final notice of intent to levy, a taxpayer requests a CDP hearing. At the hearing, the taxpayer claims that because she suffers from a medical condition requiring medication, a levy would leave her unable to pay for the medication she needs and still meet basic living expenses. However, the taxpayer, who is unrepresented, does not provide evidence to substantiate her medical condition and the cost of treatment. The Appeals Officer sustains the proposed levy, and the taxpayer petitions the Tax Court for a review of the Appeals Officer's determination. At trial, the taxpayer retains a representative, who submits documentation that demonstrates the taxpayer suffers from a medical condition and substantiates the cost of treatment. Any appeal of the Tax Court's decision will be heard by the Court of Appeals for the Second Circuit. The Tax Court admits into evidence the additional information. If an appeal of the Tax Court's decision would be heard by the First, Eighth, or Ninth Circuits, the Tax Court would not have admitted the additional information into evidence and would be unable to consider it in reaching its decision in the case.

## EXAMPLE 2

During a CDP hearing, a taxpayer, who is a construction worker with the equivalent of an eighth grade education and for whom English is a second language, submits a Form 433-A, *Collection Information Statement*, which lists his assets, liabilities, income, and expenses in support of his proposed offer in compromise (OIC). The Appeals Officer refuses to consider some of the documentation the taxpayer

9 H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998).

10 *Robinette v. Comm'r*, 123 T.C. 85 (2004), *rev'd* 439 F.3d 455 (8th Cir. 2006).

11 *Robinette v. Comm'r*, 439 F.3d 455 (8th Cir. 2006) *rev'g* 123 T.C. 85 (2004).

12 *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006) *aff'g* 125 T.C. 301 (2005); *Keller v. Comm'r*, 568 F.3d 710 (9th Cir. 2009) *aff'g in part* T.C. Memo. 2006-166; Chief Counsel Notice CC-2014-002 (May 5, 2014).

13 See *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd* 445 F.2d 985 (10th Cir. 1971), discussed below.



submits in support of his claimed income and expenses because the documents are handwritten, torn, and ungrammatical. At the conclusion of a CDP hearing, the Appeals Officer sustains the rejection of a taxpayer's OIC. The Tax Court, applying an abuse of discretion standard, upholds the Appeals Officer's determination even though the judge reviewing the case would have evaluated the documentation differently, taking into account the taxpayer's occupation, level of education, and English language skills.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6330 to specify that the standard and scope of review in Tax Court determinations under IRC § 6330, including the verification required by IRC § 6330(c)(1), is *de novo* whether or not the underlying liability is at issue.

## PRESENT LAW

### Background

The enactment of IRC §§ 6320 and 6330 as part of RRA 98 represented a profound departure from then-current tax collection procedures.<sup>14</sup> The rules for reviewing a tax deficiency as well as the rules for reviewing IRS collection action provide context for those changes.

### *Standard and Scope of Review in Deficiency Proceedings*

Prior to 1924, taxpayers had no independent forum in which to contest, on a prepayment basis, the IRS's determination of a deficiency in tax.<sup>15</sup> A taxpayer who disagreed with the IRS's determination could only pay the tax and then seek a refund in a federal district court or in the U.S. Court of Claims.<sup>16</sup> Congress remedied this situation in 1924 by creating the Board of Tax Appeals (BTA), the predecessor to the U.S. Tax Court, as an independent agency of the executive branch.<sup>17</sup> Taxpayers could request BTA review of the IRS's final deficiency determinations. Proceedings before the Board were conducted as follows:

When a taxpayer brings his case before the Board he proceeds by trial *de novo*. The record of the case made in the Internal Revenue Bureau is not before the Board except in so far as it may be properly placed in evidence by the taxpayer or by the Commissioner. The Board must decide each case upon the record made *at the hearing before it*, and, in order that it may properly do so, the taxpayer must be permitted to fully present any questions relating to his tax liability which may be necessary to a correct determination of the deficiency. To say that the taxpayer who brings his case before the Board is limited to questions presented before the Commissioner, and that the Board in its determination of the case is restricted to a decision

<sup>14</sup> Pub. L. No. 105-206, § 3401(a), (b), 112 Stat. 685 at 746, 747 (1998).

<sup>15</sup> See Walter W. Hammond, *United States Board of Tax Appeals*, 11 Marquette Law Review 1 at 8 (1926), noting that "[b]efore the establishment of the United States Board of Tax Appeals, a taxpayer did not have an opportunity to have the amount of his federal income tax determined in court before paying it nor could he secure an impartial hearing before a tribunal which did not have the dual function of being both prosecutor and judge."

<sup>16</sup> If a refund suit was brought, the court reviewed the case *de novo*. *Blair v. Curran*, 24 F.2d 390 (1st Cir. 1928).

<sup>17</sup> Revenue Act of 1924, Pub. L. No. 68-176, § 900, 43 Stat. 253, 336. The Tax Reform Act of 1969, Pub. L. No. 91-172, § 951, 83 Stat. 487, 730 amended IRC § 7441 to change the classification of the Tax Court from an agency of the executive branch to a specialized legislative court under Article I of the U.S. Constitution. IRC § 7441 was further amended by the Protecting Americans from Tax Hikes (PATH) Act, Pub. L. 114-113, Division Q, Title IV, § 441, 129 Stat. 2242, 126 (2015) to clarify that "[t]he Tax Court is not an agency of, and shall be independent of, the executive branch of the Government."

of issues raised in the Internal Revenue Bureau would be to deny the taxpayer a full and complete hearing and an open and neutral consideration of his case.<sup>18</sup>

However, the Board's determinations were not binding on the parties and the 1924 legislation did not provide for judicial review of the BTA's decisions. Thus, if the taxpayer prevailed before the BTA, the IRS could not assess the additional tax but could seek readjudication in federal court of whether a deficiency existed.<sup>19</sup> The review in federal court would be *de novo*, with the BTA's findings *prima facie* evidence of the stated facts.<sup>20</sup> If the IRS prevailed before the BTA, the IRS could immediately assess the additional tax and the taxpayer could obtain further review only by paying the additional tax and then seeking a refund in federal court, the same option available when the adverse determination was first rendered by the IRS.<sup>21</sup> Thus, if either the IRS or the taxpayer disputed the BTA's decision in court, the IRS's determination would be subject to *de novo* review more than once — first by the BTA and then by a federal court. In 1926, Congress amended the U.S. tax code to make decisions by the BTA binding on the parties and appealable to the federal court of appeals for the district in which the taxpayer was an inhabitant (or for the district in which the return was filed), or the Court of Appeals of the District of Columbia.<sup>22</sup>

The BTA is now the U.S. Tax Court, which under IRC § 6214 has jurisdiction to re-determine deficiencies.<sup>23</sup> As with proceedings before the BTA, “a trial before the Tax Court is a proceeding *de novo*; our determination as to a petitioner's tax liability must be based on the merits of the case and not any previous record developed at the administrative level.”<sup>24</sup> Thus, as Congress intended, both the scope and standard of review of IRS deficiency determinations in a prepayment forum has always been *de novo*, sometimes (for the period 1924-1926) in more than one venue.<sup>25</sup>

### *Standard and Scope of Review of IRS Collection Action*

As described above, taxpayers have long been able to obtain prepayment review of the IRS's determination to *assess* additional tax, and that review was *de novo*, but until 1998 they had no prepayment forum for contesting the IRS's decision to *collect* an assessed tax by lien or levy.<sup>26</sup> Noting that “taxes are the lifeblood

18 *Appeal of Barry*, 1 B.T.A. 156 at 157 (1924) (emphasis added). *Barry* also held that the BTA had jurisdiction to determine an overpayment for a non-deficiency year and apply that overpayment to the liability for the year in which there was a deficiency, a holding reversed by section 274(g) of the Revenue Act of 1926.

19 Revenue Act of 1924, Pub. L. No. 68-176, ch. 234, § 274(b), 43 Stat. 253, 297.

20 Revenue Act of 1924, Pub. L. No. 68-176, ch. 234, § 900(g), 43 Stat. 253, 337.

21 Revenue Act of 1924, Pub. L. No. 68-176, ch. 234, §§ 274(b), 1014, 43 Stat. 253, 297, 343. As one appellate court observed, “[t]he hearing before the Board was at that time little more than a preliminary skirmish, a run for luck. For either party, if dissatisfied with the decision, could bring a court action and try the matter *de novo*.” *Blair v. Curran*, 24 F.2d 390 (1st Cir. 1928).

22 Revenue Act of 1926, Pub. L. No. 69-20, ch. 27, §§ 1001(a), 1002, 44 Stat. 9, 109, 110. Review at this point was not *de novo*; rather, the appellate court's review was limited to evaluating the lower court's decision for errors of law. Revenue Act of 1926, Pub. L. No. 69-20, ch. 27, § 1003(a), (b), 44 Stat. 9, 110; *Avery v. Comm'r*, 22 F.2d 6 (5th Cir. 1927).

23 The Revenue Act of 1942, Pub. L. No. 77-753, ch. 619, § 504(a), 56 Stat. 798, 957 (1942) changed the name of the BTA to the Tax Court of the United States. The Tax Reform Act of 1969, Pub. L. No. 91-172 § 951, 83 Stat. 487, 730 renamed the court the United States Tax Court.

24 *Greenberg's Express, Inc. v. Comm'r*, 62 T.C. 324, 328 (1974). In fact, IRS deficiency determinations are exempt from the Administrative Procedure Act's formal adjudication requirements because they are subject to a subsequent trial *de novo* in the Tax Court on issues of both law and fact. Staff of Senate Judiciary Committee, 79th Cong., Administrative Procedure Act 22 (Comm. Print 1945) (Explanations of the provisions of the Administrative Procedure Act).

25 As noted above, taxpayers who do not seek pre-payment review of deficiency determinations may pay the proposed deficiency and request a refund from the IRS. IRC § 6402. If the IRS refuses to refund the payment, the taxpayer may seek a refund in a district court or the U.S. Court of Federal Claims, where the claim will be evaluated *de novo*. IRC § 7422; *National Right to Work Legal Defense and Ed. Foundation, Inc. v. U. S.*, 487 F.Supp. 801 (E.D.N.C. 1979).

26 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746, discussed below.

of government, and their prompt and certain availability an imperious need,” the Supreme Court, in the *Bull* case, described those antecedent procedures as follows:

Thus, the usual procedure for the recovery of debts is reversed in the field of taxation. Payment precedes defense, and the burden of proof, normally on the claimant, is shifted to the taxpayer. The assessment supersedes the pleading, proof, and judgment necessary in an action at law, and has the force of such a judgment. The ordinary defendant stands in judgment only after a hearing. The taxpayer often is afforded his hearing after judgment and after payment, and his only redress for unjust administrative action is the right to claim restitution.<sup>27</sup>

In 1998, Congress enacted IRC §§ 6320 and 6330 as part of RRA 98.<sup>28</sup> The statutes were intended to inject more procedural due process into IRS collection practices by providing for a CDP hearing at the administrative level and for Tax Court review of the IRS’s determination that results from that hearing — both to take place *before* the IRS takes its first enforced collection action with respect to a particular tax liability.<sup>29</sup>

At the CDP hearing, an IRS Appeals Officer:

- Verifies that the requirements of any applicable law or administrative procedure have been met (*e.g.*, that the underlying tax liability was properly assessed);<sup>30</sup>
- Considers issues raised by the taxpayer, such as spousal defenses, alternatives to collection, and under circumstances discussed below, the underlying tax liability;<sup>31</sup> and
- Considers “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.”<sup>32</sup>

The taxpayer, within 30 days of the Appeals Officer’s determination, may petition the Tax Court for review of the determination.<sup>33</sup>

These procedures represent a fundamental departure from the state of affairs described in the *Bull* case. However, the availability of a judicial hearing prior to levy or lien enforcement did not mean *de novo* review would be available in those Tax Court proceedings as it is in Tax Court review of proposed deficiencies.

The Senate Committee on Finance’s version of the new CDP legislation would have allowed a taxpayer to raise, at the hearing before the IRS, “any relevant issue,” including “challenges to the underlying liability

27 *Bull v. U.S.*, 295 U.S. 247, 260 (1935).

28 Pub. L. No. 105–206, § 3401, 112 Stat. 685, 746.

29 IRC §§ 6320(b)(c), 6330(b)-(d), (e). As some scholars have noted, respect for individuals’ due process rights may constitute a source of legitimacy of agency adjudications. See Paul Verkuil, *Separation of Powers, the Rule of Law, and the Idea of Independence*, 30 Wm. & Mary L. Rev. 301, 316-317 (1988). See also Richard J. Pierce, Jr., *ADMINISTRATIVE LAW TREATISE* § 2.8, Fifth Edition.

30 IRC § 6330(c)(1), (c)(3)(A).

31 IRC § 6330(c)(2), (c)(3)(B).

32 IRC § 6330(c)(3)(C).

33 IRC §§ 6230(c), 6330(d).

as to existence or amount.”<sup>34</sup> The Conference agreement, however, adopted a different approach: at the administrative hearing, “the validity of the tax liability can be challenged only if the taxpayer did not actually receive the statutory notice of deficiency or has not otherwise had an opportunity to dispute the liability.”<sup>35</sup> When a taxpayer challenged the underlying liability at the administrative hearing (not having actually received the statutory notice of deficiency or an opportunity to dispute the liability) then “[t]he amount of the tax liability will in such cases be reviewed by the appropriate court on a *de novo* basis.”<sup>36</sup> Otherwise (where the underlying liability was not properly at issue) “the appeals officer’s determination as to the appropriateness of collection activity will be reviewed using an abuse of discretion standard of review.”<sup>37</sup> Whether the underlying liability was at issue is not always clear. For example, some Tax Court decisions have held that a taxpayer’s claim that the collection statute expiration date (CSED) had passed is not a challenge to the underlying liability, while other decisions have held that CSED issues do relate to the underlying liability.<sup>38</sup>

The Conference report does not explain why the standard of review should differ depending on whether the underlying liability was at issue. The report also does not explain why an abuse of discretion standard of review, rather than the *de novo* standard that applies in deficiency cases, was thought suitable where the appropriateness of collection action, but not the underlying tax liability, was at issue.<sup>39</sup> Congress did not articulate how the abuse of discretion standard comports with general principles of administrative law, which have been described as follows:

The purpose of calibrating the breadth-or scope-of judicial review over fact finding by administrative agencies is ultimately to allocate decision-making responsibility between the executive and judicial branches. Because Congress usually makes these decisions, all three branches have a stake in the process. In assigning oversight responsibilities, Congress makes

34 S. Rep. 105-174, 105th Cong. 2d Sess. at 68 (1998). The National Taxpayer Advocate would have followed a similar approach, allowing taxpayers to raise “issues relating to the existence or amount of any liability that is eligible for an audit reconsideration or a Doubt as to Liability Offer in Compromise.” See National Taxpayer Advocate 2004 Annual Report to Congress 451, 452, Key Legislative Recommendation: *Collection Due Process Hearings*.

35 H.R. Conf. Rep. 105-599, 105th Cong. 2d Sess. Part 2, at 265 (1998). The provisions are now found in IRC §§ 6320(c), 6330(c)(2)(B); Treas. Reg. §§ 301.6320-1(e)(3), Q&A (E)(2), 301.6330-1(e)(3), Q&A (E)(2). The National Taxpayer has not supported this approach, wondering “[w]ho really cares if the taxpayer has had several opportunities to protest the liability and misses them — if the taxpayer is before us now, do we really want to collect a tax that is not, in fact, due?” See National Taxpayer Advocate 2004 Annual Report to Congress 451, 452, 459, Key Legislative Recommendation: *Collection Due Process Hearings*, recommending that Congress amend IRC § 6330(c)(2)(B) to provide that, “regardless of whether the taxpayer actually received a statutory notice of deficiency, had an opportunity to dispute such liability, or self-assessed the liability on a tax return, the taxpayer may raise issues relating to the existence or amount of any liability that is eligible for an audit reconsideration or a Doubt as to Liability Offer in Compromise.” See also National Taxpayer Advocate 2005 Annual Report to Congress 447, 449, Key Legislative Recommendations, *Restructuring and Reform of Collection Due Process Provisions*, reiterating this recommendation.

36 H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998). While the National Taxpayer Advocate at one time suggested the abuse of discretion standard could be feasible, she has reconsidered that suggestion in the light of the IRS’s continuing failure to reform its exam process, and the deterioration of IRS audit processes caused by not assigning a single employee to the vast majority of exams, making communication with taxpayers exceedingly difficult and increasing the likelihood of an incorrect result. See National Taxpayer Advocate 2004 Annual Report to Congress 451, 459, Key Legislative Recommendation: *Collection Due Process Hearings*; National Taxpayer Advocate 2005 Annual Report to Congress 447, 449, Key Legislative Recommendations, *Restructuring and Reform of Collection Due Process Provisions*, reiterating this recommendation.

37 H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998).

38 For a full discussion of this aspect of CDP hearings, see National Taxpayer Advocate 2014 Annual Report to Congress 380 (Legislative Recommendation: *Standard of Review: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date is Properly Calculated by the IRS*).

39 The Senate Committee on Finance, which also “expected” the Tax Court’s review to be for abuse of discretion, did not explain why. S. Rep. 105-174, 105th Cong. 2d Sess. at 68 (1998).

a choice: it weighs the desire for efficient and timely agency action against the need to ensure consistent and fair decision making. In balancing these considerations, Congress intends factual support for agency decisions to be subject to varying levels of scrutiny or, on occasion, to be free from scrutiny.<sup>40</sup>

Thus, general principles would suggest that the standard of review in CDP cases should balance the need for efficiency of IRS collection processes with fairness to taxpayers.

One scholar offered this explanation for why Congress chose the abuse of discretion standard:

CDP, through its general scheme of abuse of discretion review of IRS decisions regarding collection determinations, expands rule of law principles to a previously unchecked area of agency action. The pre-CDP lack of review for collection determinations reflected practical concerns about the need to collect taxes without unwanted delay, and CDP reflects Congress's newfound willingness to sacrifice somewhat efficiency in collections to promote rule of law principles.

CDP thus represents Congress's commitment to expand, in a limited way, rule of law principles to IRS collection adjudications. The expansion is limited because judicial review of collection actions is on a highly deferential abuse of discretion basis and does not extend to consideration of collection alternatives or IRS collection actions outside of CDP.<sup>41</sup>

If, as the preceding passage suggests, the new CDP rules were forged with an eye to preventing delays in collection, imposing the abuse of discretion standard of review would not have been the most efficient way to accomplish that objective.<sup>42</sup> In fact, Congress amended IRC § 6330 in 2006 to allow the Appeals Officer to disregard requests for CDP hearings that are made to delay collection.<sup>43</sup> It was also not necessary to adopt the abuse of discretion standard to prevent frivolous CDP cases. Among the matters that cannot be raised at a CDP hearing are “specified frivolous submissions” as defined in IRC § 6702(b)(2)(A).<sup>44</sup>

Whatever the reason for adopting an abuse of discretion standard, at least one scholar views it as preventing CDP from “living up to its promise.”<sup>45</sup> Recent experience supports that view. Appeals

40 Paul Verkuil, *An Outcomes Analysis of Scope of Review Standards*, 44 Wm. & Mary L. Rev. 679, 681 (2002).

41 Leslie Book, *The Collection Due Process Rights: A Misstep or A Step in the Right Direction?*, 41 Hous. L. Rev. 1145, 1168-70 (2004) (fn. refs. omitted). See also Bryan T. Camp, *Tax Administration As Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 Fla. L. Rev. 1, 86 (2004), describing how, in Senate testimony that led up to RRA 98, “[w]itnesses testified that asserted abuses came about because the Service had unreviewed power to make tax determination and tax collection decisions.”

42 Moreover, as discussed below, very few CDP hearings are requested compared to the number of CDP notices issued.

43 Tax Relief and Health Care Act of 2006 (TRHCA), Pub. L. No. 109-432, Division A, § 407, 120 Stat. 2960 added paragraph (g) to IRC § 6330, which provides: “Notwithstanding any other provision of this section, if the Secretary determines that any portion of a request for a hearing under this section or section 6320 meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A), then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.”

44 IRC § 6330 (c)(4)(B). TRHCA, Pub. L. No. 109-432, added section (c)(4)(B) to IRC § 6330 and expanded IRC § 6702 to allow for the imposition of a penalty of up to \$5,000 where a request for a CDP hearing is “either based on a position the IRS has identified as frivolous or reflects a desire to delay or impede the administration of federal tax laws.” IRC § 6702(b)(2)(A)(i) & (ii), (B)(i), (c). See S. Rep. 109-336, at 49-50 (2006).

45 Bryan T. Camp, *The Failure of CDP, Part 2: Why It Adds No Value*, 104 Tax Notes 1567, 1569 (2004), noting “CDP adds no value to the review of what information there is; court review is a mere snapshot review of what is an ongoing process and, further, courts review only for an abuse of discretion.”



Officers, who must normally consider hazards of litigation in resolving their cases, now cite the abuse of discretion standard of review as a reason for not considering hazards of litigation in CDP cases.<sup>46</sup>

The Conference report is silent as to the appropriate scope of review in CDP cases. In *Robinette*, the Tax Court held its review of IRC § 6330 cases is not limited to the administrative record.<sup>47</sup> The appellate court reversed, noting:

The Tax Court seemed to believe that because it traditionally has conducted *de novo* proceedings in deficiency proceedings, and because Congress did not change that practice when it passed the APA [the Administrative Procedure Act] in 1946, Congress should likewise be presumed to have intended *de novo* proceedings in the Tax Court in connection with the review of decisions by an appeals officer under § 6330. We do not think the proposed conclusion follows from the history. Collection due process hearings under § 6330 were newly-created administrative proceedings in 1998, and the statute provided for a corresponding new form of limited judicial review. The nature and purpose of these proceedings are different from deficiency determinations, and it is just as likely that Congress believed judicial review of decisions by appeals officers in this context should be conducted in accordance with traditional principles of administrative law. Indeed, that Congress provided for judicial review in either the Tax Court or a United States District Court, depending on the type of underlying tax liability involved, indicates that traditional principles of administrative law should apply. Every district court to consider an appeal under § 6330 has limited its review to the record created before the agency, see *Olsen*, 414 F.3d at 154 n. 9, and it would be anomalous to conclude that Congress intended in § 6330(d) to create disparate forms of judicial review depending on which court was reviewing the decision of an IRS appeals officer in a collection due process proceeding.<sup>48</sup>

Two other courts of appeal agree with the Eighth Circuit's decision in the *Robinette* case.<sup>49</sup> The Tax Court continues to reject the IRS's position that review under IRC § 6330 is limited to the administrative record, except in cases that would be appealable to the First, Eighth, or Ninth Circuit Courts of Appeal.<sup>50</sup> In any event, one source of potential divergence in opinion, identified above by the *Robinette* appellate

46 Treas. Reg. § 601.106(f)(2) provides that "Appeals will ordinarily give serious consideration to an offer to settle a tax controversy on a basis which fairly reflects the relative merits of the opposing views in light of the hazards which would exist if the case were litigated." See National Taxpayer Advocate 2013 Annual Report to Congress Most Serious Problem: *Collection Due Process Hearings: Current Procedures Allow Undue Deference to the Collection Function and Do Not Provide the Taxpayer a Fair and Impartial Hearing* 155, 162-63 (reporting that IRS Appeals, in its response to TAS's research request regarding the hazards of litigation, responded "Collection Due Process cases can be reviewed by the Tax Court, but only for an abuse of discretion, not on the actual case resolution.").

47 *Robinette v. Comm'r*, 123 T.C. 85, 95 (2004).

48 *Robinette v. Comm'r*, 439 F.3d 455, 461 (8th Cir. 2006) (fn. ref. omitted).

49 *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006), *aff'g* 125 T.C. 301 (2005); *Keller v. Comm'r*, 568 F.3d 710 (9th Cir. 2009) *aff'g in part* T.C. Memo. 2006-166.

50 Pursuant to the rule in *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd* 445 F.2d 985 (10th Cir. 1971), the Tax Court will defer to a Court of Appeals decision which is squarely on point where appeal from the Tax Court decision lies to that Court of Appeals. Pursuant to IRC § 7482(b)(1)(G), for CDP petitions filed after Dec. 19, 2014, the venue will lie with the Court of Appeals where the petitioner's legal residence is found (if the petitioner is an individual), and where the principal place of business or principal office or agency is found (if the petitioner is an entity other than an individual). IRC § 7482(b)(1)(G) was added by the PATH Act, Pub.L. No. 114-113, Division Q, Title IV, § 423, 129 Stat. 2242, 3123 (2015).



court, has been eliminated: CDP cases are no longer appealable to district courts, but only to the Tax Court.<sup>51</sup>

## REASONS FOR CHANGE

### The Abuse of Discretion Does Not Allow Sufficient Judicial Scrutiny of IRS Collection Due Process (CDP) Determinations

Review of CDP determinations for an abuse of discretion, except where the underlying liability is at issue, results in minimal scrutiny of the very IRS determinations that have the greatest impact on taxpayers. The *de novo* standard of review applicable in deficiency proceedings, which prevents “deny[ing] the taxpayer a full and complete hearing and an open and neutral consideration of his case,” should apply, perhaps with even greater force, to CDP proceedings.<sup>52</sup> There is no stated congressional objective being served by the current abuse of discretion standard.

Permitting *de novo* review, *i.e.*, affording no deference to Appeals’ conclusions, supports *taxpayers’ right to appeal an IRS decision in an independent forum*.<sup>53</sup> Particularly because IRS collection actions are where “theoretical” assessments have real and lasting impact, allowing the Tax Court to more completely consider facts and circumstances that might affect taxpayers’ ability to pay enhances their *right to a fair and just tax system*.<sup>54</sup> *De novo* review would also better position the court to determine whether the proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary, thus protecting *taxpayers’ right to privacy*.<sup>55</sup> As discussed below, subjecting IRS collection determinations to more scrutiny than the abuse of discretion standard permits could actually improve the efficiency of IRS collection activities while better ensuring “consistent and fair decision making.”<sup>56</sup> Thus, changing the standard of review would be consistent with fundamental concepts of administrative law.

### The Abuse of Discretion Standard May Lead Appeals Officers to Not Settle Cases

As discussed below, most taxpayers who seek Tax Court review of the IRS’s CDP determination are not represented. Thus, they are unlikely to be aware of or take into consideration the judicial standard of review in CDP cases. Appeals Officers, however, are certainly aware that the abuse of discretion standard applies and virtually guarantees the government will prevail in Tax Court, and in that event, the government can proceed with collection. Thus, Appeals Officers and IRS attorneys have less incentive to settle a CDP case without a trial. In contrast, in a deficiency case where the standard of review is *de novo* and prevailing in Tax Court does not trigger immediate collection activity, the IRS’s incentive to settle is stronger.<sup>57</sup>

51 The Pension Protection Act of 2006, Pub. L. No. 109-280 § 855(a), 120 Stat. 780, 1019, enacted on Aug. 17, 2006, amended 6330(d)(1) to provide exclusive jurisdiction to the Tax Court in all CDP cases, regardless of which court had jurisdiction over the underlying liability.

52 *Appeal of Barry*, 1 B.T.A. 156 at 157 (1924) (emphasis added).

53 See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

54 *Id.*

55 *Id.*

56 Paul Verkuil, *An Outcomes Analysis of Scope of Review Standards*, 44 Wm. & Mary L. Rev. 679, 681 (2002).

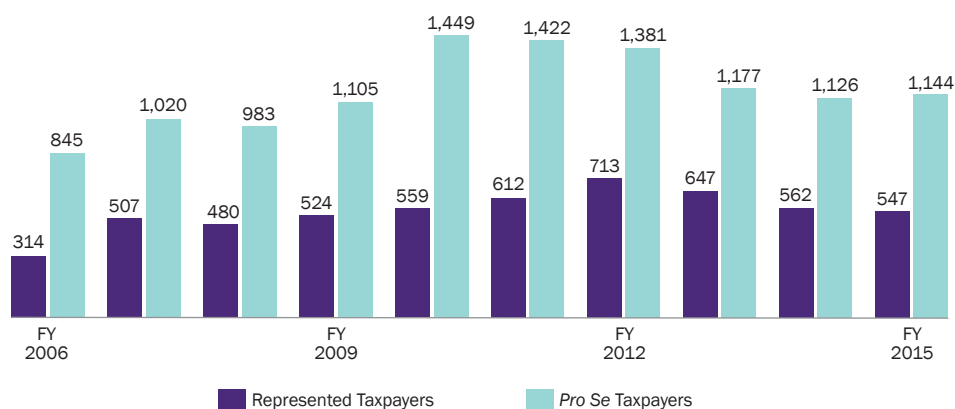
57 It is worth noting that the likelihood a taxpayer would even take the first step of requesting a CDP hearing is actually slim. For example, although the IRS sent more than 1.7 million CDP notices to individual taxpayers in fiscal year (FY) 2015, only about 56,000 CDP hearings were requested — a take-up rate of only 3.2 percent. FY 2015 notices issued from the Individual Master File on the IRS Compliance Data Warehouse.

### Limiting the Scope of Review Is Burdensome for Taxpayers, Particularly for Unrepresented Taxpayers

Perhaps even more burdensome to taxpayers than the abuse of discretion standard of review is the position that Tax Court review in CDP cases is confined to the administrative record. Unrepresented taxpayers in particular are less likely to appreciate the importance of raising an issue and substantiating their position when they are dealing with an Appeals Officer. When they later try to introduce evidence in support of their claims, the record review rule would prevent them from doing so, thus undermining their *right to challenge the IRS's position and be heard*.<sup>58</sup> In fact, most taxpayers who petition the Tax Court for review in CDP cases proceed without representation (*i.e.*, they proceed “*pro se*”). Figure 2.4.1 shows the number of represented and *pro se* taxpayers filing CDP petitions from fiscal years (FYs) 2006-2015.<sup>59</sup>

**FIGURE 2.4.1**

#### Represented and *Pro Se* Taxpayers Filing CDP Petitions, FYs 2006-2015



Moreover, a significant portion of all cases the Tax Court tried and decided in recent years (*i.e.*, cases that were not settled or disposed of due to the taxpayer's default) were CDP cases. Figure 2.4.2 shows the portion of Tax Court cases that were tried and decided that were CDP cases.<sup>60</sup>

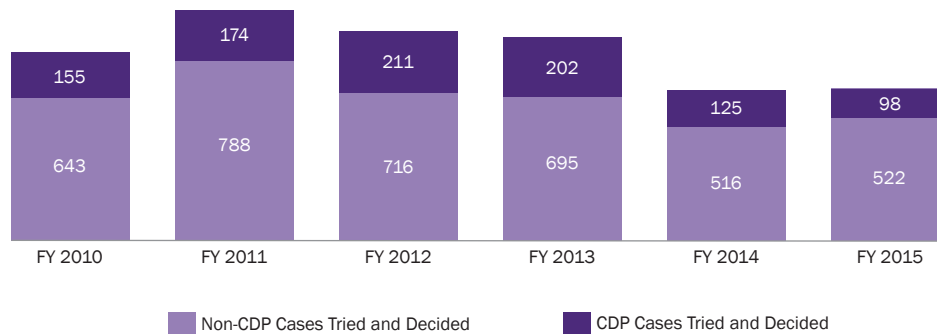
58 See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

59 American Bar Association (ABA), Tax Section Court Procedure Committee, IRS Office of Chief Counsel, FY 2015, 23.

60 *Id.* at 16, 24.

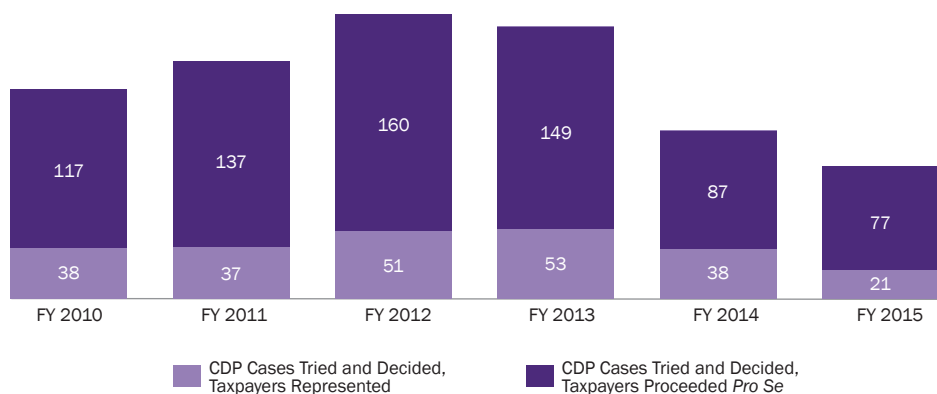
FIGURE 2.4.2

## Tried and Decided Tax Court Cases, FYs 2010-2015



In the CDP cases the Tax Court tried and decided, the taxpayer usually proceeded *pro se*. Figure 2.4.3 shows the number of CDP cases the Tax Court tried and decided in the past five fiscal years, and the portion in which the taxpayer proceeded *pro se*.<sup>61</sup>

FIGURE 2.4.3

CDP Cases the Tax Court Tried and Decided by Represented and *Pro Se* Taxpayers, FYs 2010-2015

Thus, the Tax Court judges are on the front lines of tax administration and see the difficulties unrepresented taxpayers face as they attempt to navigate the system and produce documents. In view of the likelihood that taxpayers will proceed without representation, the Tax Court has designed its procedures to assist unrepresented taxpayers. For example, pursuant to agreements with some Low Income Taxpayer Clinics (LITCs) and other student tax clinics, the Tax Court sends taxpayers who do not already have representation in a docketed case a “stuffer” or notice that informs them LTC assistance may

61 ABA, Tax Section Court Procedure Committee, IRS Office of Chief Counsel, FY 2015, 25.

be available.<sup>62</sup> In addition, some participating clinics, some bar associations, integrated bars, and other professional organizations provide free assistance to unrepresented taxpayers by participating in calendar call programs.<sup>63</sup>

Moreover, consistent with its awareness of the realities of litigation before it, the Tax Court, in its considered opinion, continues to adhere to the *Robinette* rule where it can. Congress should defer to the Tax Court's wisdom and experience here, and adopt the *Robinette* rule. Clarifying that the scope of review is not limited to the administrative record would codify the Tax Court's interpretation of IRC § 6330 and resolve the divergence between the Tax Court and the Courts of Appeals. Thus, similarly situated taxpayers would be treated the same independently of which Court of Appeals would hear their case. Similarly, just as a *de novo* standard of review may encourage settlement of CDP cases, a *de novo* scope of review may encourage Appeals Officers to more diligently secure information to support their determinations. The abuse of discretion standard of review, together with the record rule in certain appellate jurisdictions, leave Appeals Officers with less incentive to build the strongest possible case.

## EXPLANATION OF RECOMMENDATION

Amending IRC § 6330 to specify that the Tax Court standard and scope of review of CDP cases is *de novo* would clarify that the Tax Court is not required to defer to IRS determinations to proceed with enforced collection. Under this recommendation, an Appeals Officer's determination that the verification requirements of IRC § 6330(c)(1) were met, including ensuring that the CSED was properly calculated, would also be reviewed *de novo*. The Tax Court would decide *de novo* matters such as whether the taxpayer is entitled to an installment agreement, whether the taxpayer's OIC should be accepted, whether the taxpayer's account should be placed in currently not collectible status because levy would cause economic hardship, and whether the taxpayer has satisfied the requirements of IRC § 6323(j) for the withdrawal of a notice of federal tax lien. The recommendation would also clarify that the Tax Court's review is not limited to the administrative record. These changes would support taxpayers' rights by ensuring access to an independent judicial forum in which the outcome is not unduly influenced by the conclusions reached by the IRS or restricted to evidence introduced at the administrative level, and by removing impediments to judicial consideration of taxpayers' facts and circumstances.

62 In recognition of the need for low income taxpayers to have access to representation before the IRS and the courts, Congress in 1998 created Low Income Taxpayer Clinics (LITCs). IRC § 7526; RRA 98 § 3601(a). The clinics, which are independent from the IRS, represent low income taxpayers before the IRS and the Tax Court for free or no more than a nominal fee. IRC § 7526(b)(2). See Publication 4134, *Low Income Taxpayer Clinic List* (Aug. 2016) for a listing of LITCs. According to IRC § 7526(b)(1)(B), taxpayers whose income does not exceed 250 percent of the poverty level are low income taxpayers for purposes of qualifying for LTC assistance.

63 "Calendar call" refers to the procedure, once a case is scheduled for trial, of calling each scheduled case so that "counsel or the parties" can indicate to the court their estimate of how much time, if any, will be required for trial. See Rule 131(c), Tax Court Rules of Practice and Procedure.

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## COLLECTION DUE PROCESS (CDP): Amend Internal Revenue Code § 6330 to Require Appeals Officers, in Considering Collection Alternatives, to Suspend Collection Due Process (CDP) Hearings Pending Resolution of Challenged Non-CDP Liabilities or Precluded CDP Liabilities

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

- *The Right to Quality Service*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Finality*
- *The Right to a Fair and Just Tax System*

### PROBLEM

Prior to 1998, taxpayers had no prepayment forum in which to contest the IRS's decision to collect an assessed tax by lien or levy. The collection due process (CDP) provisions of Internal Revenue Code (IRC) §§ 6320 and 6330, enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98), were intended to “increase fairness to taxpayers” by requiring the IRS to “afford taxpayers adequate notice of collection activity and a meaningful hearing” before depriving them of their property.<sup>2</sup>

Of the 22,300 taxpayers whose CDP cases were closed in fiscal year (FY) 2016, 44 percent also had liabilities for non-CDP years.<sup>3</sup> The National Taxpayer Advocate has recommended that IRS Appeals Officers be required to suspend a CDP hearing when a taxpayer raises a liability issue for a non-CDP year that would be included in collection alternatives covered by the CDP hearing, but the IRS has declined to adopt this recommendation.<sup>4</sup> As a consequence, taxpayers may be required to choose between a collection alternative that does not properly reflect their final tax liability or no collection alternative at all. The same result may follow from an Appeals Officer's refusal to consider a taxpayer's challenge to the existence or amount of a liability for a CDP year, on the basis that such a challenge is a “precluded” issue.

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. 105-206, § 3401, 112 Stat. 685, 746; S. Rep. No. 105-174, at 67 (1998). See also J. Comm. on Tax'n, *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98, 81 (Nov. 24, 1998). As discussed below, the statutes provide for a hearing before the IRS (a CDP hearing), and for Tax Court review of the IRS's determination that results from that hearing, before the IRS takes enforced collection action. IRC §§ 6320(b), (c), 6330(b)-(d), (e).
- 3 TAS Research analysis of IRS Compliance Data Warehouse (CDW), Individual Master File (IMF), Transaction History Table and Status History Table, 2016 for Fiscal Year (FY) 2016. Of 22,252 taxpayers whose CDP cases were closed in FY 2016, 9,876 (44 percent) also had liabilities for non-CDP years.
- 4 National Taxpayer Advocate 2013 Annual Report to Congress Most Serious Problem: *Collection Due Process Hearings: Current Procedures Allow Undue Deference to the Collection Function and Do Not Provide the Taxpayer a Fair and Impartial Hearing* 155, 163. The IRS declined to adopt the recommendation, responding: “[s]uch a system would be impractical to implement as the underlying liability should be determined by Compliance not by Appeals and issues exists in attempting to keep an action suspended in Appeals for a potentially significant time.” National Taxpayer Advocate FY 2015 Objectives Report to Congress, vol. 2, 63.

## EXAMPLE

Taxpayer X has an unpaid \$40,000 tax liability for 2014. When the IRS proposes to collect the liability by levying on X's assets, X requests a CDP hearing. At the hearing, X requests to enter into a streamlined installment agreement (IA), with payments to be made as direct debits from her bank account. X prefers a streamlined IA, which is generally available to taxpayers whose aggregate unpaid liability does not exceed \$50,000, because neither a formal application on Form 9465, *Installment Agreement Request*, nor a supporting Form 433-F, *Collection Information Statement*, is required.

The Appeals Officer has the authority to resolve X's case through an IA, but is required to include all open tax periods (not only those that are the subject of the CDP hearing) in the agreement. X has an outstanding liability for 2013 of \$25,000 that resulted from an audit of her return and the issuance of a notice of deficiency. X did not petition the Tax Court for review of the 2013 deficiency. Thus, her aggregate liability is \$65,000 and a streamlined IA is not available. However, as X explains to the Appeals Officer, she is seeking audit reconsideration of the 2013 liability and believes that after reconsideration, the 2013 liability will amount to only \$3,000. In that event, X's total outstanding liability will be \$43,000, and a streamlined IA would be available.

Alternatively, X would be willing to enter into an offer in compromise (OIC) based on doubt as to liability (with respect to the non-CDP year) or doubt as to collectability. X's reasonable collection potential is \$45,000 (*i.e.*, sufficient to pay the combined 2014 liability and the 2013 liability if it is ultimately established she owes less than \$5,000 for 2013, but insufficient to pay the combined amount of the 2014 and unadjusted 2013 liabilities).

X requests that the Appeals Officer suspend the CDP hearing pending the outcome of the audit reconsideration, or while X's OIC based on doubt as to liability for the non-CDP year is being evaluated. The Internal Revenue Manual (IRM) does not provide authority for the Appeals Officer to do so, and the Appeals Officer rejects the request. Thus, in order to resolve her liability through an IA, X would be required to enter into a regular (non-streamlined) agreement for \$65,000. If her 2013 tax liability, after audit reconsideration, is less than \$25,000, X may seek modification of the IA.

X could resolve her liability with an OIC based on doubt as to collectability, but only if she first withdraws her OIC based on doubt as to liability with respect to the non-CDP year. With an OIC based on doubt as to collectability, X would be required to resolve the liabilities for both tax years and to offer \$45,000, her reasonable collection potential. The OIC would not be subject to modification (and audit reconsideration would no longer be available). Thus, X would be required to assume the risk of entering into an OIC in an amount that, as audit reconsideration may have shown, exceeds her total tax liability for both 2013 and 2014.

X withdraws her offer to enter into an IA, and does not pursue an OIC. The Appeals Officer issues a notice of determination for tax year 2014 upholding the levy. If X petitions the Tax Court for review of the notice of determination, the court will not have jurisdiction to determine X's 2013 liability and may find that the Appeals Officer did not abuse her discretion by refusing to suspend the CDP hearing pending the outcome of the audit reconsideration, or evaluation of an OIC based on doubt as to liability for 2013.

Similar consequences would result if X, rather than challenging the amount of her liability for a non-CDP year, is precluded from challenging a liability for a CDP year. X could qualify for a streamlined IA if the IRS determined her precluded liability was lower.



## RECOMMENDATION

To ensure that meaningful CDP hearings fairly and completely resolve taxpayers' liabilities early in the collection process, the National Taxpayer Advocate recommends that Congress amend IRC § 6330 to require Appeals Officers, in considering collection alternatives in CDP cases, to suspend the hearing while a taxpayer is challenging the existence or amount of a non-CDP liability, or a CDP liability that the Appeals Officer is precluded from considering. This could be accomplished by adding a new section 6330(c)(2)(C) providing:

For purposes of this section, when a tax and period not included in the notice specified in subsections (a)(1) and (a)(3)(A) or in section (f), or an underlying tax liability precluded from being raised in the hearing by section 6330(c)(2)(B) or (c)(4)(A), is required to be included in a collection alternative, and the person requesting the hearing disputes the existence or amount of such other tax and period, the hearing shall be suspended to give the person requesting the hearing whose dispute is not intended to delay a reasonable opportunity to obtain from the Service a decision regarding the existence or amount of such tax liability, including the Service's evaluation of an offer in compromise based on doubt as to liability.

## PRESENT LAW

### Statutory Framework

Congress enacted the CDP provisions of IRC §§ 6230 and 6330 after extensive Senate Finance Committee hearings in which witnesses described then-current IRS tax collection practices.<sup>5</sup> Michael Saltzman, a tax attorney with over 33 years of experience and the author of a seminal treatise on tax practice and procedure, described the IRS's Service Center collection practices as follows:

In the usual case, the taxpayer attempts to correspond with the service center about a notice, but does not include full payment of the amount billed. The correspondence is not acted upon and the automated collection process continues. Accordingly, the service center computer generates another notice threatening collection action, and the taxpayer, now frustrated and fearful that the IRS will levy on a bank account or other property, writes another letter. Service center personnel either fail to act on this correspondence, or act on it by contacting the taxpayer, but they sometimes fail to see to it that a hold on collection is input. As a result, a levy is sent to the bank or even to an employer.<sup>6</sup>

Saltzman noted that collection procedures in IRS district offices were also inadequate to protect taxpayers' rights:

As your hearings have confirmed, revenue officers in IRS district Collection Divisions have enormous discretion in taking collection action against taxpayers, including the filing of notices of federal tax liens against their property, serving levies, and seizing and selling their property. Taxpayers are deprived of their property without due process because there is no statutory procedure for any independent review of the revenue officer's collection decision....

<sup>5</sup> *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong. (1998) (the first set of Senate hearings were held on Jan. 28, 29; Feb. 5, 11, and 25, 1998); *IRS Oversight: Hearings Before the S. Comm. on Finance*, 105th Cong. (1998) (the second set of Senate hearings were held on April 28, 29, 30, and May 1, 1998).

<sup>6</sup> *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong. 126, 375 (1998) (Michael Saltzman's Feb. 5, 1998 testimony and responses to questions from Senator Roth).

Furthermore, whether because of restrictions on their actions or possibly the incompleteness of their training, problem resolution officers often seem more intent on closing a case than in solving taxpayer problems.<sup>7</sup>

IRC §§ 6320 and 6330 were intended to inject more procedural due process into IRS collection practices by providing for a CDP hearing at the administrative level and for Tax Court review of the IRS's determination that results from that hearing — both to take place before the IRS takes enforced collection action.<sup>8</sup> The hearing before an Appeals Officer is intended to interrupt the cycle of miscommunication between taxpayers and the IRS, fueled by the IRS's automated processes — described in the Senate testimony — and to ensure that IRS employees solve taxpayer problems rather than simply close cases.

The statutory framework contemplates complete resolution of the CDP case early in the collection process, by allowing taxpayers to raise “any relevant issue relating to the unpaid tax or the proposed levy.”<sup>9</sup> IRC § 6330 provides a nonexclusive list of what these issues could be:

- Spousal defenses;
- Challenges to the appropriateness of collection actions; and
- Offers of collection alternatives.<sup>10</sup>

A taxpayer may challenge the existence or amount of the underlying liability “for any tax period”<sup>11</sup> if the taxpayer “did not receive a statutory notice of deficiency for that tax liability or did not otherwise have an opportunity to dispute the tax liability.”<sup>12</sup> Otherwise, a challenge to the underlying liability is a “precluded issue” and may not be raised at the CDP hearing. The following additional precluded issues may not be raised at the CDP hearing:

- An issue that was raised and considered at a previous CDP hearing or in any other previous administrative or judicial proceeding in which the person seeking to raise the issue meaningfully participated;
- A “specified frivolous submission” as defined in IRC § 6702(b)(2)(A);<sup>13</sup> and
- For returns filed for partnership tax years beginning after December 31, 2017, an issue with respect to which a final determination in a proceeding brought under subchapter C of chapter 63 (pertaining to the tax treatment of partnership items) has been made.<sup>14</sup>

According to applicable Treasury regulations, “in the Appeals officer’s sole discretion, however, the Appeals officer may consider the existence or amount of the underlying tax liability, or such other precluded issues,

<sup>7</sup> *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong. 376, 377 (1998) (Michael Saltzman’s Feb. 5, 1998 testimony and responses to questions from Senator Roth).

<sup>8</sup> IRC §§ 6320(b), (c), 6330(b)-(d), (e).

<sup>9</sup> IRC § 6330(c)(2)(A).

<sup>10</sup> *Id.*

<sup>11</sup> Treas. Reg. § 301.6330-1(e)(1) rephrases this provision as “to any tax period specified on the CDP Notice” (emphasis added).

<sup>12</sup> IRC § 6330(c)(2)(B). Treas. Reg. § 301.6330-1(e)(1) clarifies that “underlying liability” includes a liability reported on a self-filed return, and “for any tax period” means “any tax period specified on the CDP Notice.”

<sup>13</sup> IRC § 6330 (c)(4)(B). Tax Relief and Health Care Act of 2006 (TRHCA), Pub. L. 109-432, added section (c)(4)(B) to IRC § 6330 and expanded IRC § 6702 to allow for the imposition of a penalty of up to \$5,000 where a request for a CDP hearing is “either based on a position the IRS has identified as frivolous or reflects a desire to delay or impede the administration of federal tax laws.” IRC § 6702(b)(2)(A)(i) & (ii), (B)(i), (c). See S. Rept. 109-336, at 49-50 (2006).

<sup>14</sup> IRC § 6330(c)(4)(A)-(C), as amended by Pub. L. 114-74, Title XI, § 1101(d), (g), 129 Stat. 637, 638 (Nov. 2, 2015).

at the same time as the CDP hearing.”<sup>15</sup> Nothing in the statute or regulations specifies the extent to which an Appeals Officer may, or is required to, take into consideration matters pertaining to non-CDP years. IRC § 6330 was amended in 2006 to allow the Appeals Officer to disregard requests for CDP hearings that are made to delay collection.<sup>16</sup>

At the CDP hearing, an IRS Appeals Officer:

- Verifies that the requirements of any applicable law or administrative procedure have been met;<sup>17</sup>
- Considers issues raised by the taxpayer, such as spousal defenses, alternatives to collection, and under circumstances discussed below, the underlying tax liability;<sup>18</sup> and
- Considers “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.”<sup>19</sup>

At the conclusion of the CDP hearing, the Appeals Officer issues a notice of determination.<sup>20</sup> Neither Congress nor the IRS has ever imposed a timeframe within which the Appeals Officer must make a determination. On the contrary, to preserve the meaningfulness of CDP hearings, Congress cautioned that “a proposed collection action should not be approved solely because the IRS shows that it has followed appropriate procedures.”<sup>21</sup>

In 1999, the IRS and Treasury issued temporary regulations interpreting the new CDP provisions and received comments from the public.<sup>22</sup> As the preamble to the final regulation notes:

One commentator requested that the final regulations establish formal procedures for the conduct of a CDP hearing as well as procedures for the admission and preservation of evidence to be considered by Appeals. Treasury and the IRS have declined to adopt this comment. Section 6320 and section 6330 are intended to give all taxpayers a right to an impartial Appeals review of the filing of a NFTL [notice of federal tax lien] or of an intended levy action, with an additional right of judicial review of the Appeals determination. Section 6330(c) (applicable to both sections) and the proposed regulations under section 6320 and section 6330 (as modified by final regulations) already set out the specific requirements, including the issues to be considered, for a CDP hearing and require that Appeals issue a written determination (Notice of Determination) setting forth Appeals’ findings and decisions. *Due to the varied circumstances of taxpayers and the varied situations in which the filing of a NFTL or an intended levy action may arise, the final regulations provide flexibility regarding the manner in which a CDP hearing may be conducted.*<sup>23</sup>

15 Treas. Reg. § 301.6330-1(e)(3), Q&A- E11.

16 TRHCA § 407, 120 Stat. 2960 added paragraph (g) to IRC § 6330, which provides: “Notwithstanding any other provision of this section, if the Secretary determines that any portion of a request for a hearing under this section or section 6320 meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A), then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.”

17 IRC § 6330(c)(1), (c)(3)(A).

18 IRC § 6330(c)(2), (c)(3)(B).

19 IRC § 6330(c)(3)(C).

20 Treas. Reg. § 301.6330-1(e)(3), Q&A- E8.

21 S. REP. NO. 105-174, at 68 (1998).

22 T.D. 8809, 1999-7 I.R.B. 27, *Notice and Opportunity for Hearing Before Levy*, 64 FR 3405-01.

23 T.D. 8980, 2002-6 I.R.B. 477, *Notice and Opportunity for Hearing Before Levy*, 67 FR. 2549-01 (emphasis added).

The only reference in the regulations to timeframes for making CDP determinations makes clear that there is no specified timeframe:

Q–E9. Is there a period of time within which Appeals must conduct a CDP hearing or issue a Notice of Determination?

A–E9. No. Appeals will, however, attempt to conduct a CDP hearing and issue a Notice of Determination as expeditiously as possible under the circumstances.<sup>24</sup>

The regulation does not define what is meant by “expeditious,” but a standard dictionary definition is “acting or done in a quick *and efficient* way.”<sup>25</sup> A notice of determination that fails to completely and fairly resolve a CDP case creates *inefficiency* by generating downstream work. More importantly, if the taxpayer is not able to resolve with the IRS the amount of his or her liabilities, and include the correct amount of those liabilities in a collection alternative, the IRS may collect tax improperly.

The taxpayer, within 30 days of the Appeals Officer’s determination, may petition the Tax Court for review of the determination.<sup>26</sup> The Tax Court has jurisdiction to review the Appeals Officer’s determination with respect to taxable periods included in the notice of determination.<sup>27</sup>

### Internal Revenue Manual (IRM) Provisions

Recognizing that a taxpayer’s liability may not have been conclusively determined at the time of the CDP hearing, the IRM identifies several situations in which the Appeals employee must suspend the hearing pending the outcome of other proceedings that involve a CDP year. For example, if a taxpayer who has requested a CDP hearing seeks innocent spouse relief or files a bankruptcy petition, the CDP hearing will be suspended.<sup>28</sup> The National Taxpayer Advocate recommended that Appeals Officers be required to suspend CDP hearings when taxpayers seek audit reconsideration of a CDP year.<sup>29</sup> The IRS has partially implemented this recommendation by requiring suspension of a CDP hearing in two situations:

- When a taxpayer’s amended return results in audit reconsideration of a CDP year;<sup>30</sup> or
- When an original return for a CDP year filed with Appeals is referred for processing to the Automated Substitute for Return Program because the assessed liability was based on a substitute for return.<sup>31</sup>

24 Treas. Reg. § 301.6330-1(e)(3), Q&A- E9.

25 MERRIAM-WEBSTER DICTIONARY, <http://www.merriam-webster.com/dictionary/expeditious> (emphasis added) (last visited Dec. 19, 2016).

26 IRC §§ 6230(c), 6330(d).

27 Any determination an Appeals Officer makes with respect to a precluded issue is not part of the notice of determination and is not subject to judicial review. Treas. Reg. § 301.6330-1(e)(3), Q&A- E11. Moreover, the taxpayer can ask the court to consider only an issue that was raised in the taxpayer’s IRC § 6330 hearing. Treas. Reg. § 301.6330-1(f), Q&A- E3. The Tax Court has jurisdiction to review an Appeals Officer’s determination, under IRC § 6330(g), to disregard all or part of a hearing request because it was based on a frivolous position or reflects a desire to delay or impede the administration of federal tax laws. *Thornberry v. Comm’r*, 136 T.C. 356 (2011).

28 See IRM 8.22.5.8 (4), *Substantive Contact Letters (SCL)* (Nov. 8, 2013) (containing a table showing common reasons why a CDP case would be suspended).

29 National Taxpayer Advocate 2004 Annual Report to Congress 451, 452, Key Legislative Recommendation: *Collection Due Process Hearings*.

30 See IRM 8.22.8.7.1.1(1), *Audit of the Taxpayer’s Self-filed Return* (Nov. 8, 2013).

31 See IRM 8.22.8.7.2, *ASFR/SFR* (Automated Substitute for Return/Substitute for Return) (Sept. 23, 2014).

Appeals Officers appear to have discretion to suspend CDP hearings in other situations in which audit reconsideration is being sought for a CDP year.<sup>32</sup>

However, the IRM does not provide for suspending the CDP hearing when the tax year for which the taxpayer seeks reconsideration is a non-CDP year. This seems anomalous, considering that:

- IRC § 6330 permits a taxpayer to raise “any relevant issue relating to the unpaid tax or the proposed levy;”<sup>33</sup> and
- Applicable regulations give Appeals Officers discretion to consider precluded issues, including the existence or amount of the underlying tax liability for a CDP year, which is arguably more far-reaching authority than the authority to suspend the hearing.<sup>34</sup>

Moreover, in considering collection alternatives, Appeals Officers are required to include all open tax periods in the resolution, even years that are not part of the CDP hearing.<sup>35</sup> The IRM identifies only two situations in which Appeals Officers may consider non-CDP years, both relating to collecting the tax:

- Where an overpayment from a non-CDP period may be available to pay the unpaid tax for the CDP period as long as it does not involve a liability determination of the non-CDP period;<sup>36</sup> and
- Where a carryover adjustment from a non-CDP period has already been made and may affect the tax due for the CDP year.<sup>37</sup>

### Case Law

In *Jones v. Commissioner*, a taxpayer requested a CDP hearing and on the same day requested audit reconsideration for the same years as the CDP years.<sup>38</sup> He requested that the Appeals Officer await the outcome of the audit reconsideration so that he could better evaluate his collection alternatives. The court, noting that Treasury regulations provide that an Appeals Officer will “attempt to conduct a \* \* \* [section 6330 hearing] and issue a Notice of Determination as expeditiously as possible under the circumstances,” found that the Appeals Officer did not abuse his discretion “by declining to delay his determinations to await the uncertain outcome of petitioner’s eleventh-hour request for audit

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- 32 IRM 8.22.8.5 (5) *At Issue, Precluded or Precluded but Considered Outside of CDP* (Nov. 8, 2013) provides: [i]f the precluded liability is an audit assessment, it is generally quicker for the taxpayer to request an audit reconsideration from one of the designated Campus locations. Provide the taxpayer with Publication 3598, which explains the audit recon process and provides the campus addresses. Proceed with the hearing if a liability will remain for the CDP periods even if the taxpayer is successful in audit reconsideration. If the potential reduction will affect the collection alternatives the taxpayer qualifies for, you may suspend the CDP hearing until the reconsideration is complete.
- 33 IRC § 6330(c)(2)(A). Not only does the IRM not contemplate suspension of the hearing, but IRM 8.22.5.5.4, *The Merits of a Non-CDP Tax Liability* (Sept. 30, 2014) provides “[t]axpayers may not raise a non-CDP tax period liability by characterizing it as a ‘relevant issue’ under IRC 6330(c)(2)(A).”
- 34 Treas. Reg. § 301.6330-1(e)(3), Q&A- E11.
- 35 IRM 8.22.7.1(2) *Overview* (Nov. 5, 2013), provides that “[a]ll open tax periods must be included when resolving a case through: Installment Agreement (IA)[,] Offer in Compromise (OIC)[, and] Currently not Collectible (CNC).”
- 36 See IRM 8.22.8.23.1, *Overpayment of a Non-CDP Tax Liability* (Sept. 23, 2014), providing, in part, “[a] non-CDP tax period may be considered if it does not involve an evaluation of the merits of the liability. The availability of an overpayment from a non-CDP period as a source of payment of the unpaid tax for the CDP period may be raised as a relevant issue under IRC 6330(c)(2)(A).” See also IRS Chief Counsel Notice CC-2011-021 (Sept. 19, 2011), noting IRS Chief Counsel’s position that “[t]he availability of an overpayment from a non-CDP period as a source of payment of the unpaid tax for the CDP period, however, may be raised as a relevant issue under section 6330(c)(2)(A) when the Service has already agreed that the taxpayer is entitled to the overpayment.”
- 37 See IRM 8.22.8.23.2, *Net Operating Loss and Carryover Adjustments* (Sept. 23, 2014).
- 38 T.C. Memo. 2007-142.

reconsideration and the uncertain outcome of any audit reconsideration that might be granted.”<sup>39</sup> The court granted the government’s motion for summary judgment. The opinion notes that according to the taxpayer, audit reconsideration was actually ongoing while the case was docketed in the Tax Court.<sup>40</sup> Thus, it is possible that the audit reconsideration resulted in an adjustment to the taxpayer’s liability and that the IRS collected more than the taxpayer’s adjusted liability – an unfair and inefficient outcome.

In *Baltic v. Commissioner*, at the conclusion of a CDP hearing, the Appeals employee determined to postpone collection by levy pending the outcome of the taxpayers’ requested audit reconsideration of the CDP year, and pending the IRS’s evaluation of the taxpayers’ OIC based on doubt as to liability for non-CDP years.<sup>41</sup> However, the Appeals employee sustained the lien filing. The taxpayers argued that the Appeals employee’s refusal to consider the OIC herself, or at least to wait before issuing the notice of determination until the audit reconsideration and OIC had been evaluated, was an abuse of discretion. Relying on the *Jones* case, and noting “[t]he settlement officer here was just heeding the exhortation of the applicable regulation to issue a notice of determination as expeditiously as possible,” the court granted the government’s motion for summary judgment.<sup>42</sup> As in the *Jones* case, this outcome may have been more rapid than awaiting consideration of proposed collection alternatives, but it was not necessarily efficient. Thus, it is unclear whether the notice of determination was actually issued “expeditiously.”

In *Lister v. Commissioner*, the Appeals Officer issued a notice of determination for tax years (TYs) 1993 and 1994 and the taxpayer sought Tax Court review of TYs “1993 through present.”<sup>43</sup> The Tax Court held it had jurisdiction to review the notice of determination with respect to TYs 1993 and 1994, but “[i]f the Appeals Office did not make a determination with respect to a particular taxable period under section 6330, the absence of a determination is grounds for dismissal of a petition regarding such period.”<sup>44</sup>

However, in *Freije v. Commissioner*, the Tax Court held it would consider facts and issues arising in non-CDP years where relevant to a claim that the tax in a CDP year had already been paid.<sup>45</sup> In *Perkins v. Commissioner*, the Tax Court, relying on *Freije*, held that the court has jurisdiction to review a determination by Appeals about the availability of an overpayment credit shown on the account of a non-CDP year as a source of payment of the unpaid tax subject to the CDP hearing.<sup>46</sup> The Appeals Officer’s determination about whether the period of limitations on refunds should have been suspended in a non-CDP year under IRC § 6511(h), which would have allowed an overpayment arising in the non-CDP year to be applied to satisfy the CDP liability, was an abuse of discretion.<sup>47</sup>

39 *Jones v. Comm’r*, T.C. Memo. 2007-142, slip op. at 2, quoting from Treas. Reg. § 301.6330-1(e)(3), Q&A- E9.

40 *Id.* at n. 3.

41 129 T.C. 178 (2007).

42 *Baltic v. Comm’r*, 129 T.C. 178, 183 (2007).

43 T.C. Memo. 2003-17, slip op. at 3.

44 *Id.* slip op. at 4.

45 125 T.C. 14, 24 (2005).

46 T.C. Memo. 2008-103.

47 *Id.* In *Weber v. Comm’r*, 138 T.C. 348, 368-69 (2012), the Tax Court clarified it only has jurisdiction to consider an overpayment credit that is already “available” because it has already been determined by the IRS or a court but not jurisdiction to make “available” a credit by determining the liability for a non-CDP period.



## REASONS FOR CHANGE

The purpose of enacting the CDP provisions was to provide a mechanism for considering all collection alternatives and resolving covered liabilities early in the collection process. Practice has shown that many CDP cases involve taxpayers with liabilities for non-CDP years. Of the 22,252 taxpayers whose CDP cases were closed in FY 2016, 9,876 (44 percent) also had liabilities for non-CDP years.<sup>48</sup>

Experience shows that resolution of the tax liability of non-CDP years can impact the collection alternatives available for the CDP year. In considering collection alternatives during a CDP hearing, Appeals Officers must include all open years in the resolution, including non-CDP years. Non-CDP years may be eligible for audit reconsideration or capable of resolution through an OIC based on doubt as to liability. Unless a taxpayer claims a net operating loss or credit carryover from a non-CDP year to a CDP year, an Appeals Officer is not required to consider or suspend the hearing to permit the taxpayer to attempt to resolve with the IRS the amount of tax liability for a non-CDP year. It does not appear the Tax Court would have jurisdiction to review an Appeals Officer's decision not to suspend the CDP hearing in this situation. Taxpayers may also seek to challenge the underlying liability for a CDP year, but if such a challenge is a precluded issue, the Appeals Officer is not required to consider it or to suspend the CDP hearing to allow the taxpayer to seek resolution through audit reconsideration, or through an OIC based on doubt as to liability.

If Appeals Officers are not required to suspend the CDP hearing in these situations while appropriate collection alternatives can be identified, the IRS may be improperly collecting tax, and the CDP hearing will not be an expeditious resolution of the case because there will be costly rework downstream. Moreover, taxpayers may be required to choose between seeking adjustment or compromise of their liability on one hand, and obtaining appropriate resolution of their tax liabilities with IRS Appeals on the other hand. Placing taxpayers in this situation undermines their *right to quality service, right to challenge the IRS's position and be heard, right to finality*, and *right to a fair and just tax system*.<sup>49</sup> Suspending CDP hearings will not inappropriately delay collection. Appeals Officers are free to ignore a CDP hearing request or issues raised in a CDP hearing when it concludes either is designed to delay collection.

## EXPLANATION OF RECOMMENDATION

IRC § 6330(c)(2)(A)(iii) requires the Appeals Officer conducting a CDP hearing to consider offers of collection alternatives. A new provision, IRC § 6330(c)(2)(C), could provide:

For purposes of this section, when a tax and period not included in the notice specified in subsections (a)(1) and (a)(3)(A) or in section (f), or an underlying tax liability precluded from being raised in the hearing by section 6330(c)(2)(B) or (c)(4)(A), is required to be included in a collection alternative, and the person requesting the hearing disputes the existence or amount of such other tax and period, the hearing shall be suspended to give the person requesting the hearing whose dispute is not intended to delay a reasonable opportunity to obtain from the Service a decision regarding the existence or amount of such tax liability, including the Service's evaluation of an offer in compromise based on doubt as to liability.

<sup>48</sup> TAS Research analysis of IRS CDW, IMF, Transaction History Table and Status History Table, for FY 2016. TAS provided the IRS with the syntax used to retrieve this data, but the IRS could neither verify nor disprove the results. IRS Appeals response to TAS fact check (Dec. 19, 2016); Small Business/Self-Employed division response to TAS fact check (Dec. 20, 2016).

<sup>49</sup> See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

The recommendation would clarify that Appeals Officers are expected to consider existing procedures for resolving outstanding liabilities in non-CDP years, dissolving the current artificial distinction between CDP years and non-CDP years for purposes of evaluating collection alternatives. The recommendation would also require Appeals Officers to suspend a CDP hearing where the taxpayer's challenge of the amount or existence of a liability for a CDP year is a precluded issue. Thus, taxpayers could work with other IRS functions to ensure that the existence and amount of all liabilities required to be included in a collection alternative are correct. Because IRC § 6330(c)(3)(B) cross references IRC § 6330(c)(2), the new provision would require the Appeals Officer, in making a determination, to take into consideration any challenges to underlying tax liabilities that require suspending the CDP hearing. Under IRC § 6330(d)(1), the Tax Court would have jurisdiction to review the IRS's actions in fashioning collection alternatives. The recommendation would not require Appeals Officers to consider non-CDP liabilities or precluded issues, but only to suspend the CDP hearing to permit the taxpayer to seek resolution of those liabilities. The recommendation would not confer jurisdiction on the Tax Court to re-determine a taxpayer's liability for non-CDP years, or to re-determine a liability for a CDP year where such liability is a precluded issue, but only to review the Appeals Officer's decision to not suspend a CDP hearing pending resolution of the taxpayer's liability for non-CDP years or a CDP year in which the liability is a precluded issue.

LR  
#6**NOTICES OF FEDERAL TAX LIEN (NFTL): Amend the Internal Revenue Code to Require a Good Faith Effort to Make Live Contact With Taxpayers Prior to the Filing of the NFTL****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

The Internal Revenue Code (IRC) authorizes the IRS to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes to protect the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and judgment lien creditors.<sup>2</sup> However, the filing of an NFTL can significantly harm the taxpayer's credit and thus negatively affect his or her ability to obtain financing, find or retain a job, secure affordable housing or insurance, and ultimately pay the outstanding tax debt.<sup>3</sup>

The Internal Revenue Manual (IRM) instructs employees to make "reasonable efforts" to contact the taxpayer before filing an NFTL, but this generally involves the issuance of the statutory assessment notice and the balance due notices in efforts "to advise that an NFTL may be filed if full payment is not made when requested."<sup>4</sup> It does not include a requirement for an outbound call, *i.e.*, a live contact with the taxpayer.<sup>5</sup> The ten calendar days of the initial attempted contact or the initial actual contact with the taxpayer provided by the IRM for preparing a request for NFTL filing or the appropriate non-filing documentation is an incredibly short period to allow any "meaningful contact" to occur, let alone enable the taxpayer to provide the IRS with a clear picture of his or her current financial situation.<sup>6</sup> Moreover, the IRS may view taxpayers as unresponsive while in fiscal year (FY) 2016 only 44 percent of taxpayers could reach the IRS using the installment agreement telephone number on the notices they were provided with.<sup>7</sup> This allows for situations where NFTLs may then be filed against taxpayers who are trying to reach

1 See Taxpayer Bill of Rights, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 IRC §§ 6321, 6322, and 6323(a).

3 See National Taxpayer Advocate 2015 Annual Report to Congress 112-22 (Most Serious Problem: *Notices of Federal Tax Lien (NFTL): The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer's Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection*).

4 Internal Revenue Manual (IRM) 5.12.2.2(1), *Taxpayer Contact* (Nov. 9, 2015).

5 A "reasonable effort" to contact the taxpayer includes "issuance of the statutory assessment notices and the balance due notices sent during the collection process ...." IRM 5.12.2.2(1), *Taxpayer Contact* (Nov. 9, 2015).

6 IRM 5.12.2.3.2(1), *Determination Requirements* (Oct. 14, 2013). The ten-day pre-filing consideration is a process of deciding whether to file, defer, or not file, an NFTL. IRM 5.12.2.3(1) (Oct. 14, 2013). About 37 percent of Accounts Management correspondence inventories are in "overage," meaning they have not been handled in the established timelines. See IRS, *Weekly Enterprise Adjustments Inventory Report*, fiscal year (FY) 2016 (week ending Oct. 1, 2016).

7 The customer service representative (CSR) level of service for the Installment Agreement/Balance Due phone number in FY 2016 was 44 percent. IRS JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2016).

the IRS and cannot, and such situations clearly erode taxpayers' trust in fair tax administration and can undermine future compliance.

In contrast, private sector creditors routinely use early intervention as a pre-collection mechanism.<sup>8</sup> It has become a standard in the mortgage industry for loan servicers to contact borrowers at least twice within the first 45 days of delinquency to discuss potential loss mitigation options available.<sup>9</sup> The Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (RESPA) require that the first contact, which must take place by the 36th day of delinquency, is a "live contact," or at least a good faith effort for live contact.<sup>10</sup>

In her 2015 Annual Report to Congress, the National Taxpayer Advocate recommended the IRS adopt an early intervention policy similar to the new standard in the mortgage industry that requires two contacts, one of which is a person-to-person attempt, rather than simply mailing a letter.<sup>11</sup> However, the IRS has declined to adopt this recommendation stating that requiring "live" contact "would inappropriately reward taxpayers actively avoiding the IRS."<sup>12</sup> This response reflects a profound misunderstanding of the value of "nudging" and taxpayer behavior, as well as an attitude toward taxpayers that assumes the worst about them.<sup>13</sup> It also suggests the IRS prefers simply "checking the box" on contacting taxpayers instead of actually attempting meaningful contact to resolve the tax liability early in the collection process.

## EXAMPLE

Taxpayer A is 58 years old. He lives paycheck to paycheck, in a rural community without access to reliable internet. Taxpayer A owes the IRS a little over \$10,000 due to an early withdrawal from his retirement account. He was recently laid off from work, lost his health insurance, and moved to a smaller house with a smaller monthly mortgage expense in the hope of paying off his rising debt. Taxpayer A received a series of notices in the mail about his tax liability and made repeated unsuccessful attempts to call the IRS toll-free line. Taxpayer A assumed the IRS knew that he has made unsuccessful attempts to reach the IRS, and finally gave up under the pressure of overwhelming life events. However, he was surprised to find out that a NFTL was filed despite his efforts. Following a job interview, his prospective employer requested a credit report for a background check, and discovered an NFTL. Taxpayer A lost the job opportunity due to the NFTL on his credit report. Also as a consequence, the interest rates on Taxpayer A's credit cards and mortgage loan increased. Without a job, Taxpayer A cannot find a way to pay off any of his tax debt while interest continues to accrue.

<sup>8</sup> See, e.g., National Service Bureau, *Pre-Collection Services (Early Intervention)*, <http://www.nsbj.net/early-out-pre-collect> (last visited Dec. 16, 2016).

<sup>9</sup> The Consumer Financial Protection Bureau (CFPB) has incorporated the need for early contact with delinquent debtors in the 2013 updated mortgage servicing rules by requiring loan servicers to contact borrowers at least twice within the first 45 days of delinquency and discuss potential loss mitigation options available, if appropriate. See 12 C.F.R. § 1024.39; Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10696, 10787-10807 (Feb. 14, 2013).

<sup>10</sup> *Id.*

<sup>11</sup> See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 112-22 (Most Serious Problem: *Notices of Federal Tax Lien (NFTL): The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer's Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection*).

<sup>12</sup> National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress, IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in the 2015 Annual Report to Congress, vol. 2, 67.

<sup>13</sup> For a discussion of the role of Behavioral Science in improving tax compliance, see Most Serious Problem: *The IRS Is Overly Focused on So-Called "Enforcement" Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6323 to require that prior to making the determination to file an NFTL, the IRS must make a “live contact,” or at least a good faith effort for “live contact,” telephonically or in-person, with the taxpayer to obtain financial information and discuss collection alternatives.

## PRESENT LAW

A federal tax lien (FTL) arises when the IRS assesses a tax liability, sends the taxpayer notice and demand for payment, and the taxpayer neglects or refuses to fully pay the debt.<sup>14</sup> The FTL is effective as of the date of assessment and attaches to all of the taxpayer’s property and rights to property, whether real or personal, including those acquired by the taxpayer after that date.<sup>15</sup> This lien continues against the taxpayer’s property until the liability either has been fully paid or is legally unenforceable.<sup>16</sup> This statutory lien is sometimes called the “secret” lien, because third parties — and usually the taxpayer — have no knowledge of the existence of this lien or the underlying tax debt.<sup>17</sup> To put third parties on notice and establish the priority of the government’s interest in a taxpayer’s property against subsequent purchasers, secured creditors, and judgment lien creditors, the IRS must file an NFTL in the appropriate location, such as a county register of deeds.<sup>18</sup> It is IRS policy not to use the NFTL as a negotiating tool.<sup>19</sup> Current law does not require the IRS to make a meaningful “live” contact, telephonically or in person, with the taxpayer *prior to* filing an NFTL.<sup>20</sup>

## REASONS FOR CHANGE

The IRS’s ability to file a NFTL, which protects the government’s interest in property against subsequent purchasers, secured creditors, and judgment lien creditors, is a power unlike that of other creditors, since the IRS does not need to obtain a judgment to file a NFTL.<sup>21</sup> The filing of a NFTL can significantly damage the creditworthiness of a taxpayer, which can negatively impact the taxpayer’s ability to obtain financing for a home or other major purchases, find or maintain a job, secure affordable rental housing or insurance, and pay the tax debt.<sup>22</sup> Several TAS studies show that NFTLs can unnecessarily harm taxpayers

14 IRC §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed. IRC § 6303 provides that within 60 days of the assessment the IRS must provide notice and demand for payment to any taxpayer liable for an unpaid tax.

15 See IRC § 6321; IRM 5.12.2.2, *Taxpayer Contact* (Nov. 9, 2015).

16 IRC § 6322.

17 IRC § 6321.

18 IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.1.4, *Purpose and Effect of Filing a Notice of Federal Tax Lien (NFTL)* (Oct. 14, 2013).

19 IRM 5.12.2.1 (Nov. 9, 2015).

20 The current law requires the IRS to provide a Collection Due Process (CDP) notice to the taxpayer not more than five business days after the day of filing the NFTL. See generally IRC §§ 6320(a)(2). The CDP lien notice must inform the taxpayer of the right to request a CDP hearing within a 30-day period, which begins on the day after the end of the five-business day period after the filing of the NFTL. IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1). The CDP hearing must be conducted by an impartial IRS Appeals Officer who has had no prior involvement. IRC § 6320(b)(3). Taxpayers have the right to judicial review of Appeals’ determinations if they timely request the CDP hearing and timely petition the United States Tax Court. IRC §§ 6320(c), 6330(d).

21 IRC §§ 6321, 6322, and 6323(a).

22 See National Taxpayer Advocate 2014 Annual Report to Congress 225; see also Heather Struck, *A Bad Credit Score Affects a Lot More Than Credit*, FORBES, Jul. 20, 2011, <http://www.forbes.com/sites/heatherstruck/2011/07/20/credit-score-fico-can-hurt-you/>; written response from Vantage Score® (Sept. 17, 2009).

and reduce their ability to become or remain compliant with their federal tax filing obligations.<sup>23</sup> NFTLs also generate significant downstream costs for the government, often without attaching to any tangible assets.<sup>24</sup> The IRS files most NFTLs based on an arbitrary dollar threshold of the unpaid liability, with over 21 percent of NFTLs filed without human involvement in determining lien filings in FY 2015 alone.<sup>25</sup> This arbitrary dollar threshold is used instead of thorough analysis of the taxpayer's individual circumstances and financial situation or consideration of the NFTL's impact on future compliance and collected revenue. Even when the taxpayer attempted to initiate contact with the IRS by calling the installment agreement/balance due number provided on the majority of notices, only 44 percent of taxpayers could get through to the IRS.<sup>26</sup>

Prior to the filing of an NFTL, the IRM instructs employees to make “reasonable efforts” to contact the taxpayer to “advise [the taxpayer] that an NFTL may be filed if full payment is not made when requested.”<sup>27</sup> Per the IRM the request for an NFTL filing or the appropriate non-filing documentation must be prepared within ten calendar days of the initial attempted contact or the initial actual contact with the taxpayer or his or her representative.<sup>28</sup> A “contact,” as defined in the IRM, is made by either a field contact, the preferred method for Revenue Officers; a telephone call; or mailing a notice or letter to the taxpayer's last known mailing address.<sup>29</sup> For this initial contact, the taxpayer may be reached in person, telephonically, or by a notice or letter sent by certified mail, delivered in person, or left at the taxpayer's last known address.<sup>30</sup> A “reasonable effort” includes “issuance of the statutory assessment notices and the balance due notices sent during the collection process ....”<sup>31</sup> This last definition simply incorporates the standard “notice collection process” — thus, there is no additional requirement to make an interpersonal contact. Moreover, the IRS does not systemically track how often each “contact” method is used.<sup>32</sup>

A majority of attempted outbound telephone calls made by the IRS Automated Collection System (ACS) uses predictive dialers and does not result in actual contact with the taxpayers.<sup>33</sup> Many IRS letters and

23 In fiscal years (FYs) 2009-2012, TAS Research & Analysis investigated the IRS's use of NFTLs and their impact on the compliance behavior of delinquent taxpayers. See National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 105-30 (TAS Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact on Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 89-100 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Study: *The IRS's Use of Notices of Federal Tax Lien*).

24 See T. Keith Fogg, *Systemic Problems with Low-Dollar Lien Filing*, 2011 TNT 194-9 (Oct. 6, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices Are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*).

25 IRS Collection Activity Report (CAR), NO-5000-25, Lien Report, September, FY 2016 (Oct. 4, 2016). In FY 2016, there were 470,602 liens filed, including 5,144 refiled liens, with 178,651 arising in the Automated Collection System (ACS). Approximately 47 percent, of ACS NFTLs are filed manually. Small Business/Self-Employed (SB/SE) response to TAS information request (Oct. 19, 2015); IRS Collection Activity Report (CAR), NO-5000-25, Lien Report, September, FY 2015.

26 IRS Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2016) (specifying that 44 percent level of service for the installment agreement line).

27 IRM 5.12.2.2(1), *Taxpayer Contact* (Nov. 9, 2015).

28 IRM 5.12.2.3.2(1), *Determination Requirements* (Oct. 14, 2013). The ten-day pre-filing consideration is a process of deciding whether to file, defer, or not file, an NFTL. IRM 5.12.2.3(1), *Notice of Federal tax Lien Filing Determinations* (Pre-filing Considerations) (Oct. 14, 2013).

29 IRM 5.12.2.2(2), *Taxpayer Contact* (Nov. 9, 2015).

30 See IRM 1.2.14.1.13, *Policy Statement* 5-47 (Oct. 09, 1996).

31 IRM 5.12.2.2(1), *Taxpayer Contact* (Nov. 9, 2015).

32 See SB/SE response to TAS information request (Nov. 6, 2015).

33 SB/SE response to TAS information request (June 10 and Oct. 19, 2015).



notices in regard to the NFTL are returned to the IRS as undeliverable mail.<sup>34</sup> Even if the taxpayer receives a notice or a phone message and attempts to call the IRS back at the number provided on the majority of notices, it is unlikely he or she will get through to the IRS to make payment arrangements prior to automated NFTL filing by ACS. In FY 2016, the level of service for the Installment Agreement/Balance Due phone number was 44 percent — that is, less than half the calls from taxpayers trying to reach the IRS to make payment arrangements actually got through.<sup>35</sup> Because of the poor level of service on the payment phone line, the IRS may view taxpayers as being unwilling to pay when they were actually trying to reach the IRS to set up payment plans. Consequently, given the short timeframes for taxpayer response to a threat of lien filing, the IRS may be filing NFTLs against taxpayers who are trying to reach the IRS but cannot without in-person, “live” communication with the taxpayer prior to the NFTL filing.

The National Taxpayer Advocate has continuously discussed the importance and usefulness of meaningful contact, specifically personal contact, rather than simply mailing letters and providing taxpayers with information regarding their payment options.<sup>36</sup> A recent TAS research study demonstrated the need for meaningful contact with taxpayers early on to improve revenue collection.<sup>37</sup> The study determined that collection decreases as time passes, with dollar collections of over twice as much during the first year as in the second year, and over three times the collections in the third year.

In the private sector, creditors routinely use early intervention as a pre-collection mechanism.<sup>38</sup> It has become a standard in the mortgage industry for loan servicers to contact borrowers at least twice within the first 45 days of delinquency to discuss potential loss mitigation options available.<sup>39</sup> The regulations for RESPA require that the first contact, which must take place by the 36th day of delinquency, is a “live contact,” or at least a good faith effort for live contact.<sup>40</sup>

34 In some cases, a taxpayer may not receive the Notice of Intent to Levy (NIL) or NFTL letter. In FY 2016, 31.5 percent of the NIL letters and 10.3 percent of the NFTL letters to individual taxpayers were undeliverable, unclaimed, or refused. TAS Research & Analysis, Individual Master File, ratio of individual taxpayers with transaction code 971 action code 67 or 68 to number of individual taxpayers with transaction code 971 action code 69 (NIL) and ratio of taxpayers with transaction code 971 action code 253, 254, or 255 to number of taxpayers with transaction code 971 action code 252 (NFTL) (Dec. 23, 2016). See IRM 5.12.6.3.17 (Oct. 14, 2013); see also National Taxpayer Advocate 2010 Annual Report to Congress 221-32 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

35 IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2016). The CSR level of service for the Installment Agreement/Balance Due phone number in FY 2016 was 44 percent. *Id.* Overall, taxpayers have to wait a significant amount of time on hold to actually speak with an assistor. The SB/SE ACS number, 800-829-3903, and the Wage & Investment ACS number, 800-829-7650, do have a significantly higher level of service, over 72 percent and over 68 percent, respectively, however the taxpayer is not provided this number until after he or she has entered into ACS and the NFTL may have already been filed by ACS. IRS JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2016). For ACS incoming calls in FY 2016, the average speed of answer was 18.2 minutes. IRS JOC, *Snapshot Reports: Product Line Detail* (week ending Sept. 30, 2016).

36 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 112-122; National Taxpayer Advocate 2014 Annual Report to Congress 226-45; National Taxpayer Advocate 2012 Annual Report to Congress 403-25; National Taxpayer Advocate 2011 Annual Report to Congress 336-47; National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 40-70; National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2008 Annual Report to Congress 114-25; National Taxpayer Advocate 2006 Annual Report to Congress 62-82, 83-109, 110-29, 141-56.

37 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 33 (*IRS Collectibility Curve*).

38 See, e.g., National Service Bureau, *Pre-Collection Services (Early Intervention)*, <http://www.nsbi.net/early-out-pre-collect> (last visited Dec. 16, 2016).

39 The Consumer Financial Protection Bureau has incorporated the need for early contact with delinquent debtors in the 2013 updated mortgage servicing rules by requiring loan servicers to contact borrowers at least twice within the first 45 days of delinquency and discuss potential loss mitigation options available, if appropriate. See 12 C.F.R. § 1024.39; Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10696, 10787-10807 (Feb. 14, 2013).

40 *Id.*

The National Taxpayer Advocate recommended the IRS to adopt an early intervention policy similar to the new standard in the mortgage industry that requires two contacts, one of which is a person-to-person attempt, rather than simply mailing a letter.<sup>41</sup> However, the IRS has declined to adopt this recommendation stating, bizarrely, that requiring “live” contact “would inappropriately reward taxpayers actively avoiding the IRS.”<sup>42</sup>

Meaningful and personal contact, such as a “soft” letter followed by a telephone call, sends a timely message to a taxpayer. Often a reminder is all that is necessary to resolve past-due debts prior to placing them in full collection. In fact, this is the very premise for the Private Debt Collection initiative — that a contact will generate payments and installment agreements.<sup>43</sup> It would be beneficial for the IRS, in terms of saving NFTL filing fees and promoting taxpayer rights and future compliance, to make “live” contact with taxpayers, or at least good faith, multiple attempts thereof, by contacting taxpayers via phone and through mailing monthly reminder notices (or SMS reminders) instead of filing an NFTL after just one attempt often made through mail correspondence.

## EXPLANATION OF RECOMMENDATION

The proposed legislative change would amend IRC § 6323, which governs NFTL filing, to require that prior to making the determination to file an NFTL, the IRS must make a “live contact,” or at least a good faith effort for live contact, telephonically or in-person, with the taxpayer to obtain financial information and discuss reasonable collection alternatives. This legislative change will modernize IRS’s NFTL filing practices by adopting the current standard in the mortgage industry under the RESPA regulations.<sup>44</sup> It will not inappropriately reward unresponsive taxpayers because the IRS will only need to make a good faith effort in reaching out to the taxpayers and would be able to issue regulations defining exactly what “reasonable effort of a live contact” means.

The Mortgage Servicing Rules under RESPA require that “a servicer shall establish or make good faith efforts to establish live contact.”<sup>45</sup> Loan servicers are to contact borrowers at least twice within the first 45 days of delinquency and discuss potential loss mitigation options available, if appropriate.<sup>46</sup> The commentary to the regulations clarifies that the rules are meant to allow flexibility, “taking reasonable steps to reach the borrower under the circumstances.”<sup>47</sup> Furthermore, if a borrower is unresponsive after repeated attempts at establishing live contact, including attempts at telephonic and written communication, then “good faith efforts” are satisfied.<sup>48</sup>

41 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 112-122 (Most Serious Problem: *Notices of Federal Tax Lien (NFTL): The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer’s Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection*).

42 National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress, IRS Responses and National Taxpayer Advocate’s Comments Regarding Most Serious Problems Identified in the 2015 Annual Report to Congress, vol. 2, 67. In its response to the National Taxpayer Advocate’s recommendation, the IRS stated that the process used in the mortgage industry is irrelevant. The National Taxpayer Advocate disagrees with the IRS’s position because the mortgage industry rule demonstrates that early intervention proves to be a successful and efficient method of collection.

43 For a detailed discussion of the IRS Private Debt Collection Program, see Most Serious Problem: *Private Debt Collection (PDC): The IRS Is Implementing a PDC Program Inconsistently With the Law and Unnecessarily Burdening Taxpayers, Especially Those Experiencing Economic Hardship*, *supra*.

44 See 12 C.F.R. § 1024.39; Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10696, 10787-10807 (Feb. 14, 2013).

45 *Id.*

46 *Id.*

47 CFPB guidance, *Implementation Guidance for Certain Mortgage Servicing Rules* (Oct. 15, 2013).

48 *Id.*

Adopting this legislative recommendation would allow the IRS, as “one of the largest financial institutions in the world,”<sup>49</sup> to catch up with the financial industry standards for early intervention in resolving delinquent accounts, save government resources on NFTL filing fees, promote taxpayer rights, and improve future compliance.

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49 IRS, *Careers Home*, <https://www.jobs.irs.gov/resources/job-descriptions/accounting-budget-finance> (last visited Dec. 16, 2016).

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#7

## INTERNATIONAL DUE DATES: Amend Internal Revenue Code § 6213(b)(2)(A) to Provide Additional Time to Request Abatement of a Mathematical or Clerical Error Assessment to Taxpayers Living Abroad Similar to the Timeframe Afforded to Taxpayers to Respond to a Notice of Deficiency

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

### PROBLEM

Approximately nine million U.S. citizens live abroad,<sup>2</sup> along with over 170,000 U.S. military service personnel and their families,<sup>3</sup> and hundreds of thousands of students and foreign taxpayers with U.S. tax obligations.<sup>4</sup> Taxpayers abroad face unique challenges in complying with complex international tax obligations that may result in inadvertent errors and mistakes.<sup>5</sup> These errors can cause the IRS to make a summary assessment of tax based on a mathematical or clerical error, bypassing regular deficiency procedures.<sup>6</sup>

While Internal Revenue Code (IRC) § 6213(a) allows international taxpayers (taxpayers living or traveling abroad) an additional 60 days to file a petition in the Tax Court in response to a statutory notice of deficiency (SNOD) (for a total of 150 days compared to 90 days allowed to domestic taxpayers), taxpayers abroad have only 60 days to file a request with the IRS for an abatement of the mathematical or clerical error assessment (the same time frame as is allowed to domestic taxpayers) pursuant to IRC § 6213(b).<sup>7</sup> As a cost saving measure, the IRS eliminated all face-to-face assistance and interactive help for taxpayers

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 The Department of State estimates that nine million U.S. citizens live abroad and more than 70 million U.S. citizens travel abroad annually. U.S. Department of State, Bureau of Consular Affairs, CA by the Numbers, Fiscal Year 2015 data, updated June 2016.
- 3 U.S. Department of Defense, Defense Manpower Data Center, Ref. No. DRS #54601, *Total Military Personnel and Dependent End Strength By Service, Regional Area, and Country - Military* (as of Sept. 30, 2015), [https://www.dmdc.osd.mil/appj/dwp/dwp\\_reports.jsp](https://www.dmdc.osd.mil/appj/dwp/dwp_reports.jsp) (last visited on Mar. 7, 2016).
- 4 National Taxpayer Advocate 2015 Annual Report to Congress 81. See also National Taxpayer Advocate 2013 Annual Report to Congress 213; National Taxpayer Advocate 2009 Annual Report to Congress 183.
- 5 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 72-81 (Most Serious Problem: *International Taxpayer Service: The IRS's Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*). See also Foreign Account Tax Compliance Act (FATCA) codified as §§ 1471-1474 & 6038D; Foreign Bank and Financial Accounts (FBAR) reporting rules, 31 U.S.C. §§ 5314, 5321; 31 C.F.R. §§ 1010.350, 1010.306(c); the Affordable Care Act (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010).
- 6 IRC § 6213(b). See also IRC §§ 6212, 6213(a).
- 7 See IRC § 6213(b)(1) and (b)(2).

abroad.<sup>8</sup> These taxpayers are left with the options of obtaining information from [irs.gov](http://irs.gov) web pages or calling the IRS International Call Center (not toll-free).<sup>9</sup>

The difficulty of taxpayers in accessing IRS services from abroad, combined with international mail delays, makes 60 days to respond to an IRS math error notice an insufficient time, and undermines these taxpayers' right to *challenge the IRS's decision in an independent forum*, because if the taxpayer fails to timely respond to a math error notice, he or she may not petition the Tax Court, the only prepayment judicial forum. Given the complexity of the international tax rules and reporting requirements, and the potentially devastating penalties for even inadvertent noncompliance, increasing the response time to 120 days similar to the framework for extending the time to respond to a SNOD, would provide these taxpayers parity with domestic taxpayers and enhance their *rights to challenge the IRS position, to pay no more than the correct amount of tax, and to a fair and just tax system*.

## EXAMPLE

Taxpayer, a U.S. citizen, relocated to China to assist her company in opening an office in Beijing. The taxpayer properly notified the IRS of her new address before moving abroad. She timely filed her U.S. tax return. On June 5, the taxpayer received a math error notice from the IRS; the notice was dated April 18. The taxpayer found the language in the notice very confusing and did not understand what was wrong with her return. The taxpayer attempted to call the IRS over the course of several days. After a lengthy wait on hold every time, however, the taxpayer was disconnected and could not reach an IRS representative. Next, the taxpayer attempted to find an accountant or attorney in Beijing who specialized in U.S. tax law. With only nine days to respond to the notice, however, the taxpayer was not able to find assistance. Her time to request abatement expired and she was assessed additional tax. The taxpayer lacks financial resources to pay the tax and then pursue refund litigation in district court or the court of federal claims.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6213(b)(2)(A) to allow 120 days for taxpayers outside the U.S. to file a request with the IRS for an abatement of an assessment arising from mathematical or clerical errors.

## PRESENT LAW

IRC § 6213(b) authorizes the IRS to make a summary assessment of tax arising from mathematical or clerical errors as defined in IRC § 6213(g), bypassing the customary deficiency procedures. Under

8 During late 2014 and 2015, the IRS eliminated the last four tax attaché posts abroad and the Electronic Tax Law Assistance Program (ETLA), and discontinued R-mail, a system that allowed customer service representatives to refer taxpayer questions to employees with specific expertise. See *Internal Revenue Service FY 2017 Budget Request: Hearing Before the S. Subcomm. on Financial Services and S. Comm. on General Government Appropriations*, 100th Cong. (2016) (written statement of Nina E. Olson, National Taxpayer Advocate), <https://www.irs.gov/advocate/national-taxpayeradvocate-congressional-testimony>. See also *The Taxpayer Advocate Annual Report to Congress: Hearing Before the Subcomm. on Gov't Operations of the H. Comm. on Oversight & Gov't Reform*, 114th Cong. (2016) (written statement of Nina E. Olson, National Taxpayer Advocate).

9 Over half of taxpayers may be unable to reach an IRS employee on the toll-free phone lines this year. The Commissioner of Internal Revenue recently estimated the level of service on the toll-free phone lines for the entire filing season would "probably be at or above 65 percent," and the level of service for the full year would be "around 47 percent." John A. Koskinen, Commissioner of Internal Revenue, Address Before the National Press Club (Mar. 24, 2016), <https://www.irs.gov/uac/March-24-2016-Commissioner-Koskinen-Speech-to-National-Press-Club>. See also IRS, *Contact My Local Office Internationally*, <http://www.irs.gov/uac/Contact-My-Local-Office-Internationally>; National Taxpayer Advocate 2013 Annual Report to Congress 205-213.

IRC § 6213(b)(2)(A), a taxpayer has 60 days, after notice is sent, to file with the IRS a request for an abatement of the assessment for mathematical or clerical errors.<sup>10</sup> An assessment made under this section may not be challenged directly in the Tax Court.<sup>11</sup> However, if the taxpayer timely requests the assessment be abated, the IRS must abate the assessment and follow normal deficiency procedures under IRC § 6212 to reassess the increase in the tax shown on the return.<sup>12</sup> Requesting an abatement of the assessment is the only way for the taxpayer to preserve the right to prepayment judicial review in the Tax Court.<sup>13</sup>

In contrast, under IRC § 6213(a), taxpayers outside of the United States are allowed a deadline of 150 days to file a petition after a notice of deficiency is mailed.<sup>14</sup> Domestic taxpayers may generally file a petition for a redetermination of the deficiency with the Tax Court within 90 days from the date that the notice is mailed.<sup>15</sup> Thus, the law allows an additional 60 days for international taxpayers to file a petition for redetermination of a deficiency.

## REASONS FOR CHANGE

Under deficiency procedures introduced in the Revenue Act of 1924, taxpayers had 60 days from the mailing of a notice of deficiency to file a petition for the redetermination of the deficiency with the Tax Court, then known as the Board of Tax Appeals.<sup>16</sup> When Congress enacted the Revenue Act of 1934, it extended the time period to petition the Tax Court to its current period of 90 days.<sup>17</sup> Congress substituted 90 days in lieu of 60 days as “[e]xperience has shown that this (60 days) is not sufficient time in case of involved assessments, or in case of taxpayers living a very great distance from Washington.”<sup>18</sup> The 150 day filing rule was adopted in 1942 to address the hardship created where a taxpayer was in a remote place and experienced delays in receiving mail during the then existing war.<sup>19</sup> After World War II concluded, 150 days to file a petition for the redetermination of the deficiency remained in the IRC. The reasons for granting additional time to taxpayers living “a very great distance from Washington” are no less true in the case of math error notices than in the case of notices of deficiency.

If a taxpayer misses the deadline to contest a math error notice with the IRS, he or she would lose the opportunity for prepayment judicial review of the IRS assessment in the Tax Court.<sup>20</sup> This would deprive the taxpayer of the *rights to challenge the IRS’s position in an independent forum and to pay no more than the correct amount of tax*.

According to the Department of State estimates, the number of U.S. citizens abroad has increased from approximately 3.8 million in 1999 to about nine million in 2015 as shown on Figure 2.7.1 below.

10 IRC § 6213(b)(2)(A).

11 IRC § 6213(b)(1).

12 IRC § 6213(b)(2)(A).

13 IRC § 6213(b)(1).

14 *Id.*

15 IRC § 6213(a).

16 Revenue Act of 1924, 43 Stat. 253, 274 (1924).

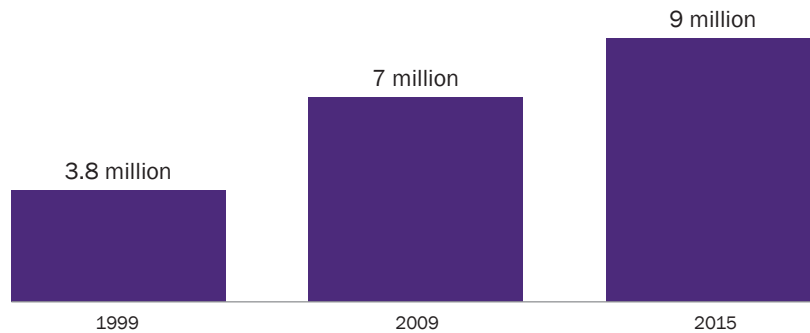
17 Revenue Act of 1934, 73 Cong. Ch. 277, 501 (1934).

18 *Hamilton v. C.I.R.*, 13 T.C. 747, 750 (1949) (quoting the H. Comm. on Ways and Means committee report).

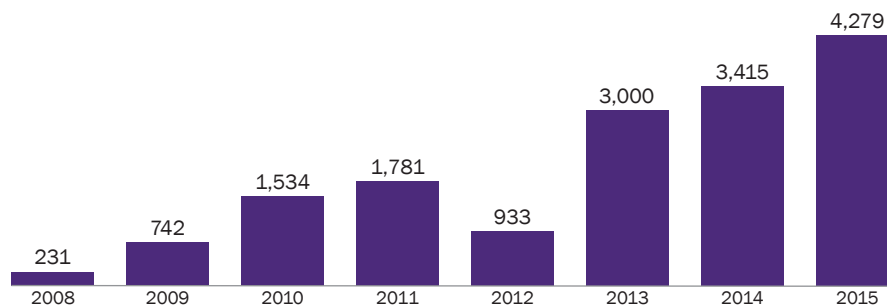
19 S. REP. No. 1631-77, at 154 (2d Sess. 1942). See also *Hamilton v. C.I.R.*, 13 T.C. 747, 750 (1949) (quoting the S. Comm. on Finance committee report).

20 IRC § 6213(b)(1).



**FIGURE 2.7.1**<sup>21</sup>**Estimates of U.S. Citizens Living Abroad in 1999-2015**

According to some repatriates and practitioners, the tax burden, including reporting obligations and potential penalties, is responsible for the surge in the number of Americans renouncing their citizenship or permanent resident status.<sup>22</sup> More renunciations have occurred in 2015 than in any other year on record as shown in Figure 2.7.2.

**FIGURE 2.7.2**<sup>23</sup>**Renunciations of U.S. Citizenships in 2008-2015**

Taxpayers abroad lack access to face-to-face service and must contend with international calling costs and delays in the IRS answering the phone. These concerns coupled with delays in international mail, language differences, time zones, unclear language in math error notices, and access to tax professionals all

21 U.S. Department of State, Bureau of Consular Affairs, *Private American Citizens Residing Abroad*, July 1999. See also U.S. Department of State, Bureau of Consular Affairs, *CA by the Numbers*, Fiscal Year 2015 data, updated June 2016.

22 National Taxpayer Advocate 2013 Annual Report to Congress 238-48 (Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act Has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*). See also CNN Money, Jethro Mullen, *Record number of Americans dump U.S. passports*, Feb. 8, 2016, <http://money.cnn.com/2016/02/08/news/americans-citizenship-renunciation/>; Jeff John Roberts, *Bye-bye, USA: Record Number Give Up Citizenship for Third Year in a Row*, *FORTUNE* (Feb. 8, 2016), <http://fortune.com/2016/02/08/renounce-us-citizenship/>.

23 Federal Register, IRS, Quarterly Publication of Individuals, Who Have Chosen to Expatriate As Required by Section 6039G, <https://www.federalregister.gov/quarterly-publication-of-individuals-who-have-chosen-to-expatriate>. See also Tom Kasprzak, *U.S. Expatriations Return to Near-Record Levels*, *TAX NOTES TODAY* (Nov. 10, 2016).

present significant barriers to compliance for taxpayers living or traveling abroad.<sup>24</sup> The failure to provide extended time frames for response to notices in the same section of the IRC is confusing and prejudicial to taxpayers abroad. Remedying this discrepancy by providing the same 60-day extension for both types of notices would protect taxpayers' rights *to pay no more than the correct amount of tax due, to appeal an IRS decision in an independent forum, to challenge the IRS's position and be heard, and to a fair and just tax system.*

### EXPLANATION OF RECOMMENDATION

Amending IRC § 6213(b)(2)(A) to provide additional time for taxpayers outside the United States would bring parity with IRC § 6213(a). With both subsections providing for the same extension of time to respond, *i.e.*, 60 additional days, taxpayers will not be prevented from contesting IRS math error notices and subsequently requesting judicial review of the deficiency in the Tax Court. IRC § 6213(a) provides 150 days for taxpayers outside of the United States to file a petition after the SNOD is mailed compared to domestic taxpayers who may file a petition for a redetermination of the deficiency with the Tax Court within 90 days from the date that the notice is mailed. Similarly, the proposed legislative change will allow an additional 60 days for international taxpayers to request an abatement in response to an IRS math error notice. This legislative change will eliminate confusion of international taxpayers about their responsibilities and adjust the length of time to respond, addressing issues with international mail, access to the IRS, and access to competent tax assistance as well as protect taxpayer rights. This would not be prejudicial to the IRS's ability to enforce its math error authority while improving the fairness of the tax system.

24 See National Taxpayer Advocate 2015 Annual Report to Congress 72 (Most Serious Problem: *International Taxpayer Service: The IRS's Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*); National Taxpayer Advocate 2014 Annual Report to Congress 163 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*); National Taxpayer Advocate 2010 Annual Report to Congress 221 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

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#8**INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs):  
Amend the Protecting Americans From Tax Hikes (PATH) Act of 2015 to Revise the Expiration Schedule for ITINs****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

Taxpayers ineligible for Social Security numbers require Individual Taxpayer Identification Numbers (ITINs) to comply with their tax filing and payment obligations, to claim dependents, and to receive other tax benefits.<sup>2</sup> ITINs are intended to be used only for tax administration purposes, and accordingly, the National Taxpayer Advocate has long recommended that the IRS deactivate ITINs no longer used for such purposes.<sup>3</sup> In late 2015, Congress amended Internal Revenue Code (IRC) § 6109 to specify that ITINs issued after 2012 would not expire unless the ITIN holder does not file a tax return with the ITIN, or is not included on another's return as a dependent for three consecutive taxable years.<sup>4</sup> Under the new law, ITINs issued before 2013 will expire at the earlier of:

- After a period of three consecutive years of nonuse (defined above), with the first deactivations required to have begun the last day of 2015; or
- On the “applicable date,” scheduled between 2017 and 2020.<sup>5</sup>

The IRS is unable to meet the schedule set forth in the Protecting Americans from Tax Hikes (PATH) Act of 2015, and has proposed a new deactivation schedule. Under the IRS's plans, all ITINs not used on a tax return for three consecutive taxable years will expire, beginning in 2017. For ITINs issued prior to 2013, the IRS will begin deactivating these in phases based on the middle digit of the ITIN, if they are not already deactivated due to nonuse.

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 For a detailed look at the characteristics of ITIN applicants in recent years, see National Taxpayer Advocate 2015 Annual Report to Congress 198-200.

3 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 334.

4 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 203(a) (2015) (containing the Protecting Americans from Tax Hikes Act of 2015) (hereinafter PATH Act) (codified at IRC § 6109(i)(3)(A)). The PATH Act § 203(f) provides that the amendments made in § 203 only apply to ITIN applications made after the effective date for the legislation. Congress introduced legislation to, among other items, clarify that the effective date provision in § 203(f) does not apply to the provisions regarding already issued ITINs. Tax Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(3) (2016); H.R. 4891, 114th Cong. § 2(e)(3) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(5) (2016); H.R. 6439, 114th Cong. § 101(f)(5) (2016).

5 IRC § 6109(i)(3)(B).

The rigid and infeasible expiration schedule mandated by the new legislation will result in the following issues that present problems for affected taxpayers and the IRS:

- There will be a discrepancy between when an ITIN is considered expired under the law and when the IRS actually deactivates it;
- The schedule has pressured the IRS to deactivate ITINs without having the proper systems in place to process renewal applications prior to the deactivation;<sup>6</sup> and
- Because of the sheer volume of ITINs requiring deactivation in a short period of time, it is infeasible for the IRS to notify all taxpayers in advance of deactivating their ITINs.

### Example 1

A taxpayer received an ITIN for his child during 2006 and has filed a tax return claiming the child as a qualified child for the Child Tax Credit (CTC) each year since. In 2016, he learned that some ITINs may be expiring and contacted the IRS to learn if his child's ITIN is one of them. The IRS informed him that it would only be deactivating ITINs with the middle digits 78 and 79,<sup>7</sup> and ITINs that have not been used at all on an individual's return during the last three years. The IRS representative advised him that his child's ITIN will not be deactivated by the IRS during 2017, and he may use the ITIN when he files his 2016 return. The taxpayer files his return, claiming the CTC for his child and listing the child's ITIN. The IRS conducts a pre-refund examination and incorrectly determines that the child does not meet the residency requirements for the CTC and thus denies the credit. The taxpayer files a petition in the U.S. Tax Court to challenge Examination's determination. He learns from a tax return preparer that under the PATH Act, all ITINs issued prior to 2008 have expired under the law. The taxpayer is uncertain as to whether he should continue to challenge the disallowance of the CTC since his child's ITIN, which is required in order to claim the CTC, has expired under the law.

### Example 2

A taxpayer received an ITIN in 2010, and used it to file her 2009, 2010, and 2011 returns, for which she had a tax return filing requirement. During 2012 through 2015, the taxpayer primarily stayed at home to care for a family member and did not earn enough income to have a tax return filing requirement. In 2016, she returned to work full-time, earning enough money to require her to file a tax return. In February 2017, the taxpayer files her return with her ITIN, claiming a small refund. The IRS sends her a math error notice, explaining that it has removed the taxpayer's personal exemption from her return because she does not have a valid taxpayer identification number (TIN) and recalculated her tax to reflect a balance due. The taxpayer now applies for an ITIN in the middle of the filing season. She is unable to pay a Certified Acceptance Agent to certify her identification documents, and she is unable to make an appointment at her local Taxpayer Assistance Center to have her documents certified because of limited hours, days, and appointments available.<sup>8</sup> As a result, the taxpayer must mail her original driver's license to the IRS, which is her only form of photo identification.<sup>9</sup> Due to the current backlog of applications during the filing season, the taxpayer has to wait over 11 weeks for the IRS to issue her ITIN, process

<sup>6</sup> See Most Serious Problem: *Individual Taxpayer Identification Numbers (ITINs): IRS Processes for ITIN Applications, Deactivations, and Renewals Unduly Burden and Harm Taxpayers*, *supra*.

<sup>7</sup> ITINs have nine digits, beginning with the number 9. Examples of ITINs that will be deactivated are: 9NN-78-NNNN or 9NN-79-NNNN.

<sup>8</sup> ITIN applicants must mail to the IRS original identification documents or copies certified by the issuing agency, or have those documents certified by a Certified Acceptance Agent or Taxpayer Assistance Center. Instructions for Form W-7 (Sept. 2016).

<sup>9</sup> At least one identification document must include a photo unless the applicant is a dependent under age 14 or a student under age 18. Instructions for Form W-7, 4 (Sept. 2016).

her return with the ITIN, and issue her refund. During this entire time, the taxpayer must drive illegally without her driver's license. Had the taxpayer known her ITIN was going to expire, she would have applied prior to the filing season.

## RECOMMENDATION

Amend IRC § 6109(i)(3)(B) to create a revised schedule for expiring ITINs issued prior to 2013. Such schedule should be developed in consultation with the IRS to ensure that (1) it is feasible for the IRS to deactivate ITINs according to this schedule, (2) the volume and timing of the deactivations allow the IRS to notify all taxpayers in advance of a deactivation, to the extent feasible, and (3) the schedule provides sufficient time for renewal applications to be received and fully processed prior to the deactivations occurring.

## PRESENT LAW

In recent years, the IRS has revised its plans to expire ITINs not used for tax administration purposes. In late 2012, the IRS announced plans to have any ITINs issued in 2013 or later automatically expire after five years, regardless of use.<sup>10</sup> Then in 2014, the IRS revised its policy to deactivate any ITIN not used at all during a period of five consecutive years regardless of when issued, with the first deactivations starting in 2016.<sup>11</sup> IRC § 6109(i)(3)(A) now provides that ITINs issued after 2012 will remain in effect unless the ITIN holder does not file a tax return or is included as a dependent on another individual's return for a period of three consecutive taxable years.<sup>12</sup> If such nonuse occurs, the ITIN will expire on the last day of the third consecutive year.<sup>13</sup> For ITINs issued prior to 2013, the ITIN will expire at the earlier of:

- If three consecutive taxable years of nonuse,<sup>14</sup> on the last day of the third consecutive taxable year; or
- On the “applicable date,” scheduled between 2017 and 2020.<sup>15</sup>

The “applicable date” is as follows:

- January 1, 2017 for ITINs issued before 2008;
- January 1, 2018 for ITINs issued in 2008;
- January 1, 2019 for ITINs issued in 2009 or 2010; and
- January 1, 2020 for ITINs issued in 2011 or 2012.<sup>16</sup>

10 See IRS, *IRS Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season*, IR-2012-98 (Nov. 29, 2012), <https://www.irs.gov/uac/newsroom/irs-strengthens-integrity-of-itin-system-revised-application-procedures-in-effect-for-upcoming-filing-season>.

11 IRS, *Unused ITINs to Expire After Five Years; New Uniform Policy Eases Burden on Taxpayers, Protects ITIN Integrity*, IR-2014-76 (June 30, 2014), <https://www.irs.gov/uac/newsroom/unused-itins-to-expire-after-five-years-new-uniform-policy-eases-burden-on-taxpayers-protects-itin-integrity>.

12 IRC § 6109(i)(3)(A).

13 *Id.*

14 “Nonuse” contains the meaning as above — the ITIN holder does not file a tax return or is included as a dependent on another's return for a period of three consecutive taxable years.

15 IRC § 6109(i)(3)(B).

16 *Id.*

Section 203(f) of the PATH Act provides that the amendments made in § 203 apply to ITIN applications made after the date of enactment, December 18, 2015.<sup>17</sup> There is an inconsistency between this provision and the provisions in § 203 that expressly address ITINs issued prior to 2013. Congress has introduced legislation to clarify, among other items, that the effective date provision in § 203(f) does not apply to the PATH Act provisions setting forth the expiration schedule.<sup>18</sup>

If passed, these bills would also slightly adjust the expiration schedule by specifying that the three consecutive taxable years of nonuse for ITINs issued after 2012 must end after the issuance of the ITIN.<sup>19</sup> The legislation would also amend the law to specify for ITINs issued before 2013, at least one of the three consecutive taxable years of nonuse must end after December 18, 2015.<sup>20</sup> For example, if the IRS issued an ITIN in calendar year 2011, and it was not used on an individual's 2012, 2013, or 2014 tax year return, but it was used on a 2015 tax year return, the ITIN would expire under the PATH Act, but would not immediately expire if the Technical Corrections Act was passed.<sup>21</sup> The bills would also change the date on which any ITIN expires for nonuse from the last day of the third consecutive taxable year of nonuse to the day after the due date for the tax return for the third consecutive taxable year of nonuse.<sup>22</sup>

## REASONS FOR CHANGE

The rigid and infeasible expiration schedule has already created problems for the IRS and taxpayers, and will continue to do so. While the IRS is able to deactivate all ITINs not used in the last three years, it has had to adopt an alternative schedule for ITINs that have been used recently, but were issued prior to 2013.<sup>23</sup> Although the legislation requires all ITINs issued prior to 2008 to expire on January 1, 2017, the IRS will only be deactivating ITINs from this group with the middle digits 78 and 79, which were issued between 1996 and 2000.<sup>24</sup> This gives rise to a discrepancy between which ITINs have *expired* under the law and which ITINs the IRS has *deactivated*. The discrepancy creates confusion for taxpayers who do not understand when their ITINs actually expire and when they need to file renewal applications. Taxpayers whose ITINs have expired under the law, but who are told by the IRS they do not need to renew at this time, may worry about the consequences down the road, should they need to challenge an

17 PATH Act § 203(f).

18 Tax Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(3) (2016); H.R. 4891, 114th Cong. § 2(e)(3) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(5) (2016); H.R. 6439, 114th Cong. § 101(f)(5) (2016).

19 Tax Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(2)(A)(i) (2016); H.R. 4891, 114th Cong. § 2(e)(2)(A)(i) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(3)(A)(i) (2016); H.R. 6439, 114th Cong. § 101(f)(3)(A)(i) (2016).

20 Tax Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(2)(B) (2016); H.R. 4891, 114th Cong. § 2(e)(2)(B) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(3)(B) (2016); H.R. 6439, 114th Cong. § 101(f)(3)(B) (2016).

21 The ITIN would still expire in the future based on the earlier of the applicable date or after three consecutive taxable years of nonuse, with one year occurring 2015 or later.

22 Technical Corrections Act of 2016, S. 2775, 114th Cong. §§ 2(e)(2)(A)(ii), 2(e)(2)(B) (2016); H.R. 4891, 114th Cong. §§ 2(e)(2)(A)(ii), 2(e)(2)(B) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. §§ 101(f)(3)(A)(ii), 101(f)(3)(B) (2016); H.R. 6439, 114th Cong. §§ 101(f)(3)(A)(ii), 101(f)(3)(B) (2016).

23 The IRS stated “due to a lack of the necessary resources to service requests for ITIN renewals for the impacted population of approximately 20 million users, we are concerned that an inability to provide those ITIN renewals in a timely manner will lead to ineffective tax administration. Seeking to avoid that situation, we developed a plan to meet the goals of the statute while ensuring taxpayers have the opportunity to renew an ITIN in a timely manner.” See IRS response to TAS information request (Nov. 29, 2016).

24 *Id.*



IRS determination in court.<sup>25</sup> If a court was to have knowledge of when a taxpayer's ITIN was issued, it would presumably have to disallow any exemptions or credits that require the taxpayer to provide a TIN, even if the IRS had not actually deactivated the taxpayer's ITIN.<sup>26</sup>

The discrepancy between what the law requires and what the IRS is capable of doing also creates uncertainty for taxpayers. The PATH Act's schedule allows ITIN holders to predict the exact date their ITINs will expire (if expiring based on the year the ITIN was issued as opposed to nonuse). However, under the IRS's alternative schedule, it does not expect to announce the next wave of deactivations (scheduled to occur in 2018) until Summer 2017.<sup>27</sup> Revising the expiration schedule mandated by the law so that the IRS may align its deactivation schedule would remove this uncertainty.

Even though the IRS will be deactivating fewer ITINs during 2017 than required by the PATH Act's schedule, it will still be deactivating approximately 11 million ITINs,<sup>28</sup> which will undoubtedly strain IRS resources. The IRS made a decision to only notify ITIN holders subject to deactivation if they submitted a return in the last three years, citing a reduced ability to contact taxpayers who had not filed recently at their last known address.<sup>29</sup> Although it may be infeasible for the IRS to contact all ITIN holders subject to deactivation prior to their deactivations, a more gradual schedule for deactivating ITINs would provide the IRS with more time and resources to notify taxpayers, not only by sending a notice to their last known address, but also by conducting greater outreach farther in advance.

## EXPLANATION OF RECOMMENDATION

This legislative change would amend IRC § 6109 to revise the schedule for expiring ITINs. To develop the revised schedule, it is helpful for Congress to consult with the IRS to take into account what the IRS is capable of doing based on technology and resource requirements. Congress should consider requesting specific information regarding the time, technology, and resources needed to process renewal applications in order to develop an expiration schedule that provides the IRS with sufficient time to receive and fully process renewal applications prior to the expirations. The schedule should also permit the IRS to notify as many taxpayers as possible who are subject to deactivation at their last known address prior to the deactivation.

This legislative recommendation will remove the discrepancy between when an ITIN expires under the law and when the IRS deactivates an ITIN, providing certainty to taxpayers. It will also provide the IRS with more time to process renewal applications, allowing taxpayers to have their applications processed upon receipt and in advance of the filing season. As such, it will reduce the burden on taxpayers who must currently wait months and delay filing their tax returns during the time between submitting their ITIN renewal applications and receiving confirmation from the IRS that they may use their ITINs. Revising the expiration schedule will provide the IRS with a greater ability to notify taxpayers about the need to renew their ITINs, protecting the taxpayers' *right to be informed*.

25 This scenario could occur in the U.S. Tax Court, a U.S. District Court, or the U.S. Court of Federal Claims. If the taxpayer's exemptions or credits were disallowed during an examination and the IRS issued a statutory notice of deficiency, the taxpayer could challenge the IRS's determination in U.S. Tax Court. See IRC § 6213(a). Alternatively, if the taxpayer paid the tax resulting from the disallowed exemptions or credits, the taxpayer could file a claim for refund and file suit in a U.S. District Court or the U.S. Court of Federal Claims to recover the tax paid. See IRC § 7422. See also 28 U.S.C. §§ 1346; 1491.

26 The IRS maintains information regarding the ITIN date of issuance on its internal system, the ITIN Real Time System. IRM 3.21.263.1, *Overview* (Oct. 4, 2016). A Taxpayer Identification Number (TIN) is required to claim a personal exemption for the taxpayer, taxpayer's spouse, or a dependent, and to claim the Child Tax Credit. See IRC §§ 151(e); 24(e).

27 See email from IRS Wage and Investment Division to TAS (Nov. 18, 2016) (on file with TAS).

28 See IRS response to TAS information request (Nov. 29, 2016).

29 *Id.*

LR  
#9**CERTIFIED ACCEPTANCE AGENTS (CAAs): Amend the PATH Act to Authorize CAAs to Certify Individual Taxpayer Identification Number Applications for Taxpayers Abroad****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

Taxpayers ineligible for Social Security numbers (SSNs) require Individual Taxpayer Identification Numbers (ITINs) to comply with their tax filing and payment obligations, claim dependents, and receive tax benefits, such as the benefits of a tax treaty.<sup>2</sup> In recent years, over 100,000 nonresident taxpayers have applied for ITINs annually.<sup>3</sup> However, options for taxpayers who reside abroad to apply for ITINs have been reduced in recent years. During late 2014 and 2015, the IRS closed all four tax attaché offices abroad.<sup>4</sup> Although the Protecting Americans from Tax Hikes Act of 2015 (hereinafter PATH Act) specifically authorizes ITIN applicants residing outside the United States to apply in person to an IRS employee,<sup>5</sup> there are no IRS offices abroad at which an applicant can apply without the attaché offices. The PATH Act also authorizes applicants who reside outside the United States to apply in person to a designee of the Secretary at a U.S. diplomatic mission or consular post,<sup>6</sup> but, citing resistance from the Department of State due to budget issues, the IRS has failed to designate anyone to certify ITIN applications at these locations.<sup>7</sup> Finally, the PATH Act eliminated the option for taxpayers residing abroad to apply through a CAA.<sup>8</sup> Although Congress has introduced legislation to fix this error, neither the Senate nor the House of Representatives has acted on the bills to date.<sup>9</sup>

The current limitations will lead to many applicants who reside abroad having to send their original documents to the IRS through international mail, requiring them to give them up for long periods of

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 For a detailed look at the characteristics of ITIN applicants in recent years, see National Taxpayer Advocate 2015 Annual Report to Congress 198-200.

3 There were 100,285 nonresident Individual Taxpayer Identification Number (ITIN) applicants in 2013, and 108,472 in 2014, the most recent years for which data is available. National Taxpayer Advocate 2015 Annual Report to Congress 199.

4 See National Taxpayer Advocate 2015 Annual Report to Congress 72.

5 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 203(a) (2015) (codified at IRC § 6109(i)(1)(B)) [hereinafter PATH Act].

6 Protecting Americans from Tax Hikes Act of 2015 (PATH Act) § 203(a) (codified at IRC § 6109(i)(1)(B)).

7 See IRS response to TAS information request (Nov. 29, 2016). See also Most Serious Problem: *Individual Taxpayer Identification Numbers (ITINs): IRS Processes for ITIN Applications, Deactivations, and Renewals Unduly Burden and Harm Taxpayers*, *supra*.

8 See PATH Act § 203(a) (codified at IRC § 6109(i)(1)(B)).

9 See Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(1) (2016); H.R. 4891, 114th Cong. § 2(e)(1) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(2) (2016); H.R. 6439, 114th Cong. § 101(f)(2) (2016).

time and risk their loss.<sup>10</sup> Removing the option for ITIN applicants who reside abroad to use a CAA results in widespread taxpayer burden and an increased strain on the IRS, which must spend more time certifying, handling, and returning original documents.<sup>11</sup> Further, it may discourage investment in the United States because foreign investors need ITINs to claim tax treaty benefits and to avoid higher withholding rates.<sup>12</sup>

## EXAMPLE

A businesswoman living in Canada has filed U.S. income tax returns every year for the past decade in order to report and pay tax on interest and dividend income she received from sources within the United States.<sup>13</sup> She is not a U.S. citizen and does not have an SSN. She received a letter from the IRS in late 2016, explaining that her ITIN would expire on January 1, 2017 because it contained the middle digits “78.”<sup>14</sup> According to the IRS website, there are 114 CAAs located in Canada.<sup>15</sup> However, because the PATH Act removes the option for her to apply through a CAA, her only option is to mail her application with the original identification documents or documents certified by the issuing agency. The taxpayer is unable to have her documents certified by the issuing agency because none of the agencies have offices near her. Because the taxpayer only has two forms of acceptable documentation that include a picture (a requirement for one of the two ITIN supporting documents),<sup>16</sup> she must either send her passport or her driver’s license to the IRS. She cannot give up her driver’s license, which she uses to drive legally in Canada. Because she needs her passport for upcoming business travel, she must delay applying for an ITIN and filing her annual U.S. tax return. This delay results in her not being able to receive a refund of U.S. tax withheld and not being able to file her Canadian tax return to claim full credit for the U.S. tax paid. As a result, the taxpayer decides to divest herself of her U.S. investments.

## RECOMMENDATION

Amend Internal Revenue Code (IRC) § 6109(i)(1)(B) to clarify that ITIN applicants residing outside the United States may apply for an ITIN in person to a CAA while located outside the United States.

## PRESENT LAW

IRC § 6109(i)(1)(B) specifies that ITIN applicants residing outside the United States may apply for an ITIN “by mail or in person to an employee of the Internal Revenue Service or a designee of the Secretary at a United States diplomatic mission or consular post.” In contrast, ITIN applicants residing in the United States may apply by mail or “in person to an employee of the Internal Revenue Service or a

10 For a discussion of the problems with mailing original documents, see National Taxpayer Advocate 2015 Annual Report to Congress 196-212 (Most Serious Problem: *Individual Taxpayer Identification Numbers (ITINs): IRS Processes Create Barriers to Filing and Paying for Taxpayers Who Cannot Obtain Social Security Numbers*). See also Letter from Richard M. Reedman, President, Nat’l Ass’n of Enrolled Agents, to John A. Koskinen, Commissioner, Internal Revenue Service (Dec. 13, 2016) (on file with TAS) (discussing the difficulty of applying for an ITIN while abroad).

11 The IRS anticipates returning original documents within 60 days of receipt for renewal applications; however, for applications submitted during the filing season or from abroad, applicants are advised to wait 11 weeks for their ITIN applications to be processed. IRS Notice 2016-48, Implementation of PATH Act ITIN Provisions, IRB 2016-33 (Aug. 15, 2016); Internal Revenue Manual (IRM) 3.21.263.2.3, *ITIN Disclosure Guidelines* (Feb. 19, 2015).

12 See IRC §§ 1441-1443, 1445, 1446.

13 See IRC § 871.

14 See IRS, *IRS Works to Help Taxpayers Affected by ITIN Changes; Renewals Begin in October*, IR-2016-100 (Aug. 4, 2016).

15 IRS, Acceptance Agents - Canada, <https://www.irs.gov/individuals/acceptance-agents-canada> (last updated Nov. 2, 2016).

16 See Instructions for Form W-7 (Sept. 2016).

community- based certified acceptance agent approved by the Secretary.”<sup>17</sup> Prior to the passage of the PATH Act, the Code contained no restrictions on how ITIN applicants could apply and who could use a CAA.

## REASONS FOR CHANGE

Prior to late 2014, taxpayers residing abroad had the following options to apply for an ITIN:

- Mailing to the IRS an ITIN application and original identification documents;
- Mailing to the IRS an ITIN application and copies of identification documents certified by the issuing agency<sup>18</sup> or certified by an employee of a U.S. consulate or embassy;<sup>19</sup>
- Applying in person to an IRS employee at one of four tax attaché offices located in Beijing, London, Paris, or Frankfurt; or
- Applying in person to a CAA who can verify and return original identification documents and send in the complete ITIN application package to the IRS.<sup>20</sup>

The closure of the tax attaché offices abroad, the lack of designated employees at U.S. consulates or embassies, and now the PATH Act’s elimination of CAAs for applicants who reside abroad results in these applicants having no option to apply for an ITIN in-person.

The CAA restriction comes at an especially bad time when the IRS has plans to deactivate millions of ITINs in the coming years, requiring taxpayers to apply to renew their ITINs if they need to file tax returns.<sup>21</sup> Although renewal applicants can apply for an ITIN outside the filing season without submitting a paper return, the application procedures are otherwise the same in terms of proving identity, foreign status, and residency through original documents or copies certified by the issuing agency.<sup>22</sup> The upcoming deactivations will likely result in a greater number of ITIN applications in coming years.

At a time when ITIN applications are expected to increase, and when strained IRS resources have led to backlogs and delays in processing applications,<sup>23</sup> there is no compelling reason to remove the option for ITIN applicants who reside abroad to use CAAs. Problems with handling and returning original identification documents are likely to grow as more applicants residing abroad feel compelled to send in original documents via international mail. Further, the restriction on using CAAs infringes on a taxpayer’s *right to a fair and just tax system* because applicants residing abroad are already at a disadvantage

17 PATH Act § 203(a) (codified at IRC § 6109(i)(1)(A)).

18 For foreign documents, the issuing agency is the agency who issued the form of identification. IRM 3.21.263.5.3.4.2.1, *Supporting Identification Documentation Certification Requirements* (Nov. 2, 2016).

19 Employees of a U.S. consulate or embassy may only certify foreign documents. IRM 3.21.263.5.3.4.2.1 *Supporting Identification Documentation Certification Requirements* (Nov. 2, 2016).

20 CAAs can only verify two types of documentation for dependents — birth certificates and passports. Instructions for Form W-7 (Sept. 2016). Although the PATH Act refers to a “certified acceptance agent,” CAAs were previously referred to and at times still referred to as “Certifying Acceptance Agents” by the IRS. See, e.g., IRM 3.21.263.3.1, *Acceptance Agent (AA) or Certifying Acceptance Agent (CAA)* (Sept. 12, 2016).

21 The PATH Act dictates that all ITINs will expire if the ITIN holder does not file a tax return (or is not included on another’s return as a dependent) for three consecutive tax years. Further, ITINs issued before 2013 will expire on a staggered basis, regardless of use. See PATH Act § 203(a) (codified at IRC §§ 6109(i)(3)). However, the IRS has indicated it will be unable to meet this schedule and will deactivate ITINs in stages based on an alternative plan. For a detailed discussion of challenges pertaining to ITIN renewals, see Most Serious Problem: *Individual Taxpayer Identification Numbers (ITINs): IRS Processes for ITIN Applications, Deactivations, and Renewals Unduly Burden and Harm Taxpayers*, *supra*.

22 See Instructions for Form W-7 (Sept. 2016).

23 See National Taxpayer Advocate 2015 Annual Report to Congress 202.

when applying for ITINs, due to their inability to apply in person to an IRS employee.<sup>24</sup> By prohibiting applicants who reside abroad from using CAAs, the PATH Act eliminated another option that is still available to domestic applicants.

Contrary to the restriction on applicants who reside abroad using CAAs, other sections of the PATH Act seem to envision an expansion of the CAA program and a move towards more in-person interviews for ITIN applicants.<sup>25</sup> Prior to the passage of the PATH Act, ITIN applicants abroad could use CAAs in 18 countries and one U.S. territory, but even some of the largest countries only had one or two CAAs each.<sup>26</sup> Instead of taking away the option of using a CAA, legislation should authorize the use of CAAs by applicants residing abroad, providing the IRS with the opportunity to study ways to increase availability of CAAs not just domestically, but worldwide.

## EXPLANATION OF RECOMMENDATION

This recommendation mirrors § 2(e)(1) of the Technical Corrections Act of 2016<sup>27</sup> and § 101(f)(2) of the Tax Technical Corrections Act of 2016,<sup>28</sup> and specifies that ITIN applicants residing abroad may apply for an ITIN in person to a CAA. Without this change, ITIN applicants who reside abroad are limited to applying by mail, in person to an IRS employee, or in person to a designated official at an U.S. diplomatic mission or consulate. Because of the lack of IRS offices abroad and the failure to appoint designated officials at U.S. diplomatic missions or consulates, taxpayers residing abroad are effectively limited to applying for an ITIN by mail. This requires sending through international mail either original identification documents or copies certified by the issuing agency. This legislative change would restore the option for applicants who reside abroad to use CAAs, which was previously available to them prior to the passage of the PATH Act. It would also increase fairness because applicants residing in the United States can currently use CAAs to certify their ITIN applications.

24 Applicants in the United States can apply in person to an IRS employee at a Taxpayer Assistance Center. See IRS, *Taxpayer Assistance Center (TAC) Locations Where In-Person Document Review Is Provided*, <https://www.irs.gov/uac/tac-locations-where-in-person-document-verification-is-provided> (Sept. 1, 2016).

25 The PATH Act provides a list of persons eligible to be CAAs, which includes among others, state and local governments, federal agencies, and other persons or categories authorized by regulations or IRS guidance. See PATH Act, § 203(c). As part of a required study on the effectiveness of the application process for ITINs, the IRS must evaluate ways to expand the geographic availability of CAAs and strategies to work with other federal agencies, state and local governments, and other organizations to encourage participation in the CAA program. *Id.* at § 203(d).

26 See National Taxpayer Advocate 2015 Annual Report to Congress 208-09.

27 S. 2775, 114th Cong. § 2(e)(1) (2016); H.R. 4891, 114th Cong. § 2(e)(1) (2016).

28 S. 3506, 114th Cong. § 101(f)(2) (2016); H.R. 6439, 114th Cong. § 101(f)(2) (2016).

LR  
#10**AFFORDABLE CARE ACT (ACA): Streamline the Religious Exemption Process for the Individual Shared Responsibility Payment (ISRP)****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

Taxpayers in the Amish and Mennonite communities have voiced concerns regarding unnecessary compliance burdens when applying for an Individual Shared Responsibility Payment (ISRP) exemption based on religion.<sup>2</sup> Taxpayers in these communities file their exemption applications with the Marketplace and experience significant delays in processing such applications.<sup>3</sup> Many taxpayers in these communities already apply for a similar exemption from Social Security and Medicare taxes by submitting to the Social Security Administration (SSA) Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*. Once the SSA approves the exemption request on Form 4029, SSA submits it to the IRS. Therefore, the IRS already has a record of a federal determination on a similar exemption request. Requiring an additional certification is unnecessary and burdensome for the taxpayer and wasteful for the government.

**EXAMPLE**

Taxpayer, who is a member of the Amish community, had previously applied for an exemption from Social Security and Medicare taxes on Form 4029. The SSA approved the exemption and forwarded the approved Form 4029 to the IRS which posted it to the taxpayer's account. Taxpayer also submitted to the Centers for Medicare and Medicaid Services (CMS) the Application for Exemption from the Shared Responsibility Payment for Members of Recognized Religious Sects or Divisions. However, CMS did not process the exemption in time to file the tax year (TY) 2015 tax return. Because the Taxpayer did not yet have an Exemption Certificate Number (ECN) to claim the exemption, the Taxpayer wrote "pending" on Form 8965, per the form instructions.

**RECOMMENDATION**

To reduce unnecessary burden on both taxpayers and the government, the National Taxpayer Advocate recommends that Congress amend Internal Revenue Code (IRC) § 5000A(d)(2) to provide that the Secretary of the Treasury has the authority to grant the religious exemption for purposes of the ISRP

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 While we have specifically received information from the Amish and Mennonite communities in Ohio, this issue may also burden other Anabaptist communities, such as Hutterites, as well as other recognized religious sects described in IRC §1402(g)(1).
- 3 See Written Statement of Ohio State Director, Amish Steering Committee, National Taxpayer Advocate Public Forum 2 (Aug. 16, 2016); Meeting with representatives of the Ohio Amish and Mennonite Community and TAS Representatives (Nov. 17, 2016).



to the taxpayer and to each person for whom the taxpayer would be liable under IRC § 5000A(a) if the taxpayer has already received approval by the SSA and the IRS for the exemption set forth in IRC § 1402(g)(1), and the regulations thereunder, and such exemption is still valid.

## PRESENT LAW

IRC § 5000A requires nonexempt individuals to have minimum essential health coverage or make an ISRP when they file a tax return. Under IRC § 5000A, a taxpayer is liable for the health coverage of himself or herself, the taxpayer's spouse (if married filing jointly), and any other individual whom the taxpayer could claim as a dependent for federal income tax purposes.<sup>4</sup> IRC § 5000A(d)(2) provides for an exemption from the ISRP for individuals who are members of a "recognized religious sect or division thereof" as defined by IRC § 1402(g)(1).

IRC § 1402(g)(1) provides for an exemption from Social Security and Medicare taxes for members of certain religious faiths. To claim the exemption, the individual needs to file an application for an exemption in the form and manner as set forth in the regulations thereunder. To qualify for the exemption, the individual must be "a member of a recognized religious sect or division thereof and is an adherent of established tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance of the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act)." This exemption is granted by the SSA if the application includes evidence of membership in and adherence to the tenets or teachings of the religion and a waiver of benefits under the Social Security Act.

Section 155.605 (c) of Title 45 of the Code of Federal Regulations (Health and Human Services regulations) provides that the Marketplace makes the eligibility determination for the exemption provided in IRC § 5000A(d)(2).<sup>5</sup> An individual may file an exemption application on behalf of himself or herself and other eligible family members, and, if granted, the exemption generally is valid in perpetuity. However, an exemption granted to a child under age 21 is valid until the end of the month following the date the individual obtains the age of 21, at which point the individual must submit a new application for exemption.

## REASONS FOR CHANGE

IRC § 5000A sets forth various exemptions from the ISRP, one of which is the exemption for religious conscience. Specifically, an individual can obtain an exemption for any month in which he or she is a member of a recognized sect or division that is recognized by the SSA as conscientiously opposed to accepting any insurance benefits, including Medicare and Social Security.<sup>6</sup> Many members of these religious groups, including the Amish and Mennonites, already request an exemption from Social Security and Medicare taxes, and waive the associated benefits, on IRS Form 4029. The taxpayer files the form directly with the SSA, which makes the exemption determination and then forwards the form to the IRS to record on its database. The exemption is valid until the taxpayer sends a letter to the IRS requesting revocation.<sup>7</sup>

Despite the fact that the Affordable Care Act defines the ISRP exemption through reference to the Social Security and Medicare tax provisions, to receive an ISRP exemption, eligible taxpayers must apply to the

<sup>4</sup> IRC § 5000A(a).

<sup>5</sup> 45 C.F.R. § 155.605.

<sup>6</sup> IRC § 5000A.

<sup>7</sup> Instructions to IRS Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*.

relevant health insurance Marketplace for an ECN. The taxpayer must then enter the ECN on Form 8965, *Health Coverage Exemptions*, to claim the exemption.

Through the National Taxpayer Advocate's Public Forums on Taxpayer Needs and Preferences, it has come to our attention that thousands of Amish constituents have applied for and never received ECNs despite repeated attempts to contact the insurance Marketplace and responding to requests for missing information.<sup>8</sup> We have heard complaints that Marketplace employees are unable to locate and provide correct information for the ECN application process in a timely manner. The procedure is time-consuming, confusing, and redundant given the well-established IRS procedure to process Form 4029.<sup>9</sup> For example, the CMS ECN application is five pages long and must be completed when an individual reaches the age of 21, upon marriage, and each time an eligible individual is born into the tax household.<sup>10</sup>

A less burdensome solution would be to discard the ECN application process and allow taxpayers to enter "4029 exempt" instead of an ECN on the applicable line in Part 1 of Form 8965. The IRS would be able to verify the information internally, because it already receives Form 4029 after it is approved by the SSA and such approval is easily accessible on IRS information systems.<sup>11</sup> By streamlining the procedures to claim an ISRP exemption for these taxpayers, the IRS would save both the taxpayers and the Marketplace time and paperwork, and reduce confusion.

## EXPLANATION OF RECOMMENDATION

Congress should amend IRC § 5000A(d)(2) to add language enabling the Secretary of the Treasury to accept, as *prima facie* proof of the taxpayer's qualification for the religious exemption from the ISRP, evidence that the taxpayer received approval for exemption from Social Security and Medicare taxes pursuant to IRC § 1402(g)(1). Such approval for the exemption under IRC § 1402(g)(1) is granted by the Secretary of the Treasury and the Commissioner of the SSA. The IRS already has a record of such exemption under IRC § 1402(g)(1) in its information system once it approves the taxpayer's Form 4029.

Not all taxpayers who qualify for the ISRP exemption file Form 4029 with the SSA and IRS. Therefore, these taxpayers will continue to have the option to file for the ECN with the Marketplace.

In addition, Form 4029, due to its abbreviated length, does not include information regarding members of the tax household. To reduce complexity, the statutory revision needs to apply the religious exemption for purposes of the ISRP to the taxpayer named on Form 4029 and to all individuals for whom the taxpayer is liable under IRC § 5000A(a).

<sup>8</sup> For more information on the National Taxpayer Advocate Public Forums, including written statements and transcripts, see [https://taxpayeradvocate.irs.gov/news/national-taxpayer-advocate-public-forum-transcripts?category=Tax News](https://taxpayeradvocate.irs.gov/news/national-taxpayer-advocate-public-forum-transcripts?category=Tax%20News) (last visited Nov. 22, 2016).

<sup>9</sup> See Written Statement of Ohio State Director, Amish Steering Committee, National Taxpayer Advocate Public Forum 2 (Aug. 16, 2016).

<sup>10</sup> Health Insurance Marketplace, *Application for Exemption from the Shared Responsibility Payment for Members of Recognized Religious Sects or Divisions* (rev. Oct. 2014).

<sup>11</sup> Such IRS information systems include Integrated Data Retrieval System (IDRS) and Individual Master File On-Line Entity (IMFOLE). Applicants file Form 4029 with the Religious Exemption Unit of SSA. SSA makes the determination whether the applicant belongs to a qualifying religious group and forwards the approved exemption application to the IRS. The IRS then makes the determination whether the applicant qualifies for exemption from social security and Medicare taxes and returns the completed form to the applicant marked "Approved." The taxpayer then writes "Form 4029" on the "self-employment tax" line in the Other Taxes section of Form 1040. IRS Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*.

## INTRODUCTION: Most Litigated Issues

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(X) requires the National Taxpayer Advocate to identify in her Annual Report to Congress (ARC) the ten tax issues most litigated in federal courts (Most Litigated Issues).<sup>1</sup> The National Taxpayer Advocate may analyze these issues to develop recommendations to mitigate the disputes resulting in litigation.

TAS identified the Most Litigated Issues from June 1, 2015, through May 31, 2016, by using commercial legal research databases. For purposes of this section of the Annual Report, the term “litigated” means cases in which the court issued an opinion.<sup>2</sup> This year’s Most Litigated Issues are:

- Accuracy-Related Penalty (IRC § 6662(b)(1) and (2));<sup>3</sup>
- Appeals From Collection Due Process (CDP) hearings (IRC §§ 6320 and 6330);
- Summons Enforcement (IRC §§ 7602(a), 7604(a), and 7609(a));
- Gross Income (IRC § 61 and related Code sections);
- Trade or Business Expenses (IRC § 162(a) and related Code sections);
- Failure to File Penalty (IRC § 6651(a)(1)), Failure to Pay Penalty (IRC § 6651(a)(2)), and Failure to Pay Estimated Tax Penalty (IRC § 6654);
- Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax (IRC § 7403);
- Charitable Deductions (IRC § 170);
- Frivolous Issues Penalty (IRC § 6673 and related appellate-level sanctions); and
- Trust Fund Recovery Penalty (IRC § 6672).<sup>4</sup>

All of these issues were identified as Most Litigated Issues last year, with the exception of the trust fund recovery penalty, which replaced relief from joint and several liability for spouses as the tenth most litigated issue.<sup>5</sup> This issue last appeared in a Most Litigated Issues section in 2005.<sup>6</sup> Accuracy-related penalties remained the top litigated issue this year, and we identified 122 cases, nine more than the 113 cases we identified last year.<sup>7</sup> This works out to an eight percent increase, the second largest increase in any category of cases. CDP cases experienced the largest percentage increase, as we identified 99 cases this year compared with 79 cases last year, a 25 percent increase.<sup>8</sup> We also observed declines from last year of more than 25 percent in three categories of cases. The number of failure to file, failure to pay, and failure

1 Federal tax cases are tried in the United States Tax Court, United States District Courts, the United States Court of Federal Claims, United States Bankruptcy Courts, United States Courts of Appeals, and the United States Supreme Court.

2 Many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers’ cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Courts can issue less formal “bench opinions,” which are not published or precedential.

3 Internal Revenue Code (IRC) § 6662 also includes (b)(3), (b)(4), (5), (6), (7), and (8), but because those types of accuracy-related penalties were not heavily litigated, we have only analyzed (b)(1), and (2).

4 In addition to the cases we identified in the ten Most Litigated Issues, we identified 42 cases under IRC §§ 7407 and 7408, which involve United States District Court actions to enjoin tax return preparers, and actions to enjoin specified conduct related to tax shelters and reportable transactions, respectively. However, because the majority of these cases did not involve substantive decisions on the merits, we did not include this category of cases in our Most Litigated Issues section.

5 See National Taxpayer Advocate 2015 Annual Report to Congress 426.

6 *Id.* at 543.

7 *Id.* at 429.

8 *Id.* at 481.

to pay estimated tax penalty cases dropped from 63 to 45, a 29 percent decrease, the largest percentage drop in any category.<sup>9</sup> Cases involving civil actions to enforce federal tax liens decreased from 44 to 32, a 27 percent decrease.<sup>10</sup> Finally, the number of trade or business expense cases dropped from 99 to 73, a 26 percent decrease.<sup>11</sup>

Overall, the total number of cases identified in the Most Litigated Issues section dropped from 640 in 2015 to 609 this year, a five percent decrease from last year,<sup>12</sup> and continuing the downward trend in the number of cases over the last few years.<sup>13</sup> We also noticed a slight dip from last year in the percentage of cases involving *pro se* taxpayers, as 60 percent of cases involved *pro se* taxpayers as compared to 62 percent in 2015.<sup>14</sup>

Once TAS identified the Most Litigated Issues, we analyzed each one in five sections: summary of findings, taxpayer rights impacted, description of present law, analysis of the litigated cases, and conclusion.<sup>15</sup> Each case is listed in Appendix 3, which categorizes the cases by type of taxpayer (*i.e.*, individual or business).<sup>16</sup> Appendix 3 also provides the citation for each case, indicates whether the taxpayer was represented at trial or argued the case *pro se* (*i.e.*, without representation), and lists the court's decision.<sup>17</sup>

We have also included a “Significant Cases” section summarizing decisions that are not among the top ten issues but are relevant to tax administration. In this section, we used the same reporting period, beginning on June 1, 2015, and ending on May 31, 2016, that we used for the ten Most Litigated Issues.

9 See National Taxpayer Advocate 2015 Annual Report to Congress 499.

10 *Id.* at 509.

11 *Id.* at 459.

12 *Id.* at 427.

13 We identified 731 cases in 2014 and 877 cases in 2013. See National Taxpayer Advocate 2014 Annual Report to Congress 425; National Taxpayer Advocate 2013 Annual Report to Congress 324.

14 See National Taxpayer Advocate 2015 Annual Report to Congress 429.

15 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

16 Individuals filing Schedules C, E, or F are deemed business taxpayers for purposes of this discussion even if items reported on such schedules were not the subject of litigation.

17 “*Pro se*” means “for oneself; on one’s own behalf; without a lawyer.” BLACK’S LAW DICTIONARY (10th ed. 2014). For purposes of this analysis, we considered the court’s decision with respect to the issue analyzed only. A “split” decision is defined as a partial allowance on the specific issue analyzed. The citations also indicate whether decisions were on appeal at the time this report went to print.

## AN OVERVIEW OF HOW TAX ISSUES ARE LITIGATED

Taxpayers can generally litigate a tax matter in four different types of courts:

- The United States Tax Court;
- United States District Courts;
- The United States Court of Federal Claims; and
- United States Bankruptcy Courts.

With limited exceptions, taxpayers have an automatic right of appeal from the decisions of any of these courts.<sup>18</sup>

The Tax Court is a “prepayment” forum. In other words, taxpayers can access the Tax Court without having to pay the disputed tax in advance. The Tax Court has jurisdiction over a variety of issues, including deficiencies, certain declaratory judgment actions, appeals from CDP hearings, relief from joint and several liability, and determination of employment status.<sup>19</sup>

The United States District Courts and the United States Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full,<sup>20</sup> and (2) the taxpayer has filed an administrative claim for refund.<sup>21</sup> The United States District Courts, along with the bankruptcy courts in very limited circumstances, provide the only fora in which a taxpayer can receive a jury trial.<sup>22</sup> Bankruptcy courts can adjudicate tax matters that were not adjudicated prior to the initiation of a bankruptcy case.<sup>23</sup>

18 See IRC § 7482, which provides that the United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) have jurisdiction to review the decisions of the Tax Court. There are exceptions to this general rule. For example, IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals \$50,000 or less) for which appellate review is not available. See also 28 U.S.C. § 1294 (appeals from a United States District Court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court). See also *Byers v. Comm’r*, 740 F.3d 668 (D.C. 2014), cert. denied, 83 U.S.L.W. 3189 (U.S. Oct. 6, 2014) (No. 14-74) (the D.C. Circuit will not transfer cases to another circuit in non-liability CDP cases unless both parties stipulate to transfer the case).

19 IRC §§ 6214; 7476-7479; 6330(d); 6015(e); 7436.

20 28 U.S.C. § 1346(a)(1). See *Flora v. United States*, 362 U.S. 145 (1960), reh’g denied, 362 U.S. 972 (1960).

21 IRC § 7422(a).

22 The bankruptcy court may only conduct a jury trial if the right to a trial by jury applies, all parties expressly consent, and the district court specifically designates the bankruptcy judge to exercise such jurisdiction. 28 U.S.C. § 157(e).

23 See 11 U.S.C. §§ 505(a)(1) and (a)(2)(A).

## ANALYSIS OF PRO SE LITIGATION

As in previous years, many taxpayers appeared before the courts *pro se*. Figure 3.0.1 lists the Most Litigated Issues for the review period June 1, 2015, through May 31, 2016, and identifies the number of cases, categorized by issue, in which taxpayers appeared without representation. As the figure illustrates, the issues with the highest rates of *pro se* appearance are CDP and the frivolous issues penalty.

**FIGURE 3.0.1, Pro Se Cases by Issue**

| Most Litigated Issue  | Litigated Cases Reviewed | Pro Se Litigation | % of Cases Involving Pro Se Taxpayers |
|---|--------------------------|-------------------|---------------------------------------|
| Accuracy-Related Penalty  | 122                      | 70                | 57%                                   |
| Collection Due Process  | 99                       | 66                | 67%                                   |
| Summons Enforcement   | 87                       | 49                | 56%                                   |
| Gross Income  | 81                       | 49                | 60%                                   |
| Trade or Business Expenses  | 73                       | 45                | 62%                                   |
| Failure to File, Failure to Pay, and Estimated Tax Penalties                        | 45                       | 28                | 62%                                   |
| Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax | 32                       | 18                | 56%                                   |
| Charitable Deductions   | 26                       | 10                | 38%                                   |
| Frivolous Issues Penalty (and analogous appellate-level sanctions)                  | 23                       | 22                | 96%                                   |
| Trust Fund Recovery Penalty   | 21                       | 6                 | 29%                                   |
| <b>Total</b>  | <b>609</b>               | <b>363</b>        | <b>60%</b>                            |



Figure 3.0.2 affirms our contention that taxpayers are more likely to prevail if they are represented. However, the disparity in the success rate between *pro se* and represented taxpayers decreased for the second consecutive year.<sup>24</sup> *Pro se* taxpayers prevailed in 17 percent of cases this year as compared to 19 percent last year, an 11 percent decrease in success rate. Notably, represented taxpayers fared worse than last year, achieving a 22 percent success rate as compared to 28 percent last year, a 21 percent decrease in success rate. Thus, for this year, the success rate for represented taxpayers was only five percent greater than that of *pro se* taxpayers.

**FIGURE 3.0.2, Outcomes for Pro Se and Represented Taxpayers**

| Most Litigated Issue  | Pro Se Taxpayers |  |            | Represented Taxpayers |  |            |
|---|------------------|--|------------|-----------------------|--|------------|
|   | Total Cases      | Taxpayer prevailed in whole or in part | Percent    | Total Cases           | Taxpayer prevailed in whole or in part | Percent    |
| Accuracy-Related Penalty  | 70               | 22                                     | 31%        | 52                    | 14                                     | 27%        |
| Collection Due Process  | 66               | 8                                      | 12%        | 33                    | 8                                      | 24%        |
| Summons Enforcement   | 49               | 1                                      | 2%         | 38                    | 7                                      | 18%        |
| Gross Income  | 49               | 3                                      | 6%         | 32                    | 5                                      | 16%        |
| Trade or Business Expenses  | 45               | 15                                     | 33%        | 28                    | 8                                      | 29%        |
| Failure to File, Failure to Pay, and Estimated Tax Penalties                        | 28               | 2                                      | 7%         | 17                    | 3                                      | 18%        |
| Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax | 18               | 1                                      | 6%         | 14                    | 1                                      | 7%         |
| Charitable Deductions   | 10               | 3                                      | 30%        | 16                    | 4                                      | 25%        |
| Frivolous Issues Penalty (and analogous appellate-level sanctions)                  | 22               | 6                                      | 27%        | 1                     | 1                                      | 100%       |
| Trust Fund Recovery Penalty   | 6                | 2                                      | 33%        | 15                    | 2                                      | 13%        |
| <b>Total</b>  | <b>363</b>       | <b>63</b>                              | <b>17%</b> | <b>246</b>            | <b>53</b>                              | <b>22%</b> |

24 See National Taxpayer Advocate 2015 Annual Report to Congress 430.

## Significant Cases

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.<sup>1</sup> These decisions are summarized below.

**In *Altera Corp. & Subs. v. Commissioner*, the Tax Court held Treasury regulations were invalid because the government failed to engage in “reasoned decisionmaking” by articulating a rational connection between the facts and the “arms-length” standard it adopted.<sup>2</sup>**

In 1997, Altera Corp. (Altera), a Delaware corporation, and its foreign subsidiary agreed to share the cost of a research and development project. However, they did not share the cost of the stock-based compensation (*e.g.*, options to purchase Altera stock) that Altera paid to employees who worked on the project. On audit, the IRS exercised its authority under Internal Revenue Code (IRC) § 482<sup>3</sup> to increase Altera’s U.S. taxable income for 2004-2007 by the amount it believed the subsidiary would have reimbursed Altera for the employees’ stock-based compensation if the agreement had been negotiated at “arm’s length.”<sup>4</sup>

The IRS has taken the position in court and in regulations proposed in 2002 that related parties must share stock-based compensation costs because that is what unrelated parties would do if dealing at arm’s length.<sup>5</sup> In response to the IRS’s proposed rule, stakeholders submitted information showing that unrelated parties do not share the cost of stock-based compensation because its value is speculative, potentially large, and outside their control. Commentators also suggested that stock option grants do not change a company’s operating expenses and do not factor into its pricing decisions.

Nonetheless, in 2003, the government issued final regulations requiring that “stockbased compensation must be taken into account ... [to satisfy the] arm’s length standard.”<sup>6</sup> The government restated its belief that parties dealing at arm’s length “generally would not distinguish between stock-based compensation and other forms of compensation.”<sup>7</sup> It distinguished the transactions cited by commentators on the basis that they did not involve the “development of high-profit intangibles,”<sup>8</sup> asserting that “there is little, if any, public data regarding transactions involving high-profit intangibles.”<sup>9</sup> However, the regulations did not distinguish between transactions involving high- and low-profit intangibles.

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2015, and ending on May 31, 2016. For purposes of this section, TAS used the same period.

2 *Altera Corp. & Subs. v. Comm’r*, 145 T.C. 91 (2015), *appeal docketed*, No. 16-70496 (9th Cir. Feb. 19, 2016).

3 IRC § 482 authorizes the Secretary to allocate income and expenses among related entities if the allocation is necessary to prevent evasion of taxes or clearly reflect the income of the entities.

4 *Altera*, 145 T.C. at 95. See also Treas. Reg. § 1.482-1(b)(1) (“the standard to be applied in every case is that of a taxpayer dealing at arm’s length with an uncontrolled taxpayer.”). The IRS could have adopted a different standard based on legislation authorizing it to use the “commensurate with income” standard, particularly in light of legislative history citing the difficulty of finding comparable transfers of high-profit potential intangibles at arm’s length between unrelated parties, but it did not. *Altera*, 145 T.C. at 96-98.

5 Prop. Treas. Reg. § 1.482-7(d)(2), 67 Fed. Reg. 48997, 49002 (July 29, 2002); Action on Decision (AOD), 2010-33 I.R.B. 240 (acq. in result in *Xilinx, Inc. & Subs. v. Comm’r*, 598 F.3d 1191 (9th Cir. 2010), *aff’g*, 125 T.C. 37 (2005), which rejected the IRS’s reallocation of the value of employee stock options under IRC § 482 because “the significance of the Ninth Circuit’s opinion was mooted by the 2003 amendments” to Treas. Reg. §§ 1.482-1(b)(1) and 1.482-7(d)).

6 T.D. 9088, 68 Fed. Reg. 51171, 51173 (Aug. 26, 2003).

7 *Id.*

8 *Id.* The term “high-profit” refers to the “subsequent success of the product.” *Altera*, 145 T.C. at 96. (internal citation omitted).

9 T.D. 9088, 68 Fed. Reg. 51171, 51173 (Aug. 26, 2003) (citation to legislative history omitted).

Following the IRS's proposed tax assessment, Altera filed suit in the Tax Court. It argued the 2003 regulations were arbitrary and capricious, and therefore, invalid under § 553(b) of the Administrative Procedure Act (APA) because the government did not explain why it rejected the comments and analysis it received from stakeholders.<sup>10</sup> Thus, the regulations were not the product of “reasoned decisionmaking,” as required under *State Farm*.<sup>11</sup> The IRS countered that the court should give deference to the regulations under *Chevron*,<sup>12</sup> that APA § 553(b) did not apply because they were interpretive (not legislative) rules, and that they were the product of reasoned decisionmaking in any event.<sup>13</sup>

The Tax Court held that the regulations were invalid. APA § 553(b) requires an agency to promulgate “legislative” rules, such as these, using the formal notice and comment rulemaking process.<sup>14</sup> Under this process, agencies must provide the public with notice of the proposed rule (regulation), consider any comments, and provide a concise statement explaining the basis for and purpose of the final rule.<sup>15</sup> Even if a court gives so-called *Chevron* deference to the regulations, they may be deemed arbitrary and capricious, and thus invalid, if an agency does not respond to significant comments and articulate a reasoned explanation for its final rule as required under *State Farm*.<sup>16</sup> An agency meets the reasoned decisionmaking test under *State Farm*, only if it examines the relevant data and contemporaneously articulates a satisfactory explanation for its action including a rational connection between the facts found and the choice made.<sup>17</sup>

In this case, the regulations were not a product of reasoned decision-making because the Treasury Department did not: (1) establish a connection between the facts found and the choice made, (2) provide a reasoned explanation for why it clung to the assumption that unrelated parties would share the cost of stock-based compensation after commentators presented evidence to the contrary, or (3) adopt an alternative rationale for the rules.<sup>18</sup> The government did not contemporaneously explain why it did not

10 5 U.S.C. § 706(2)(A) (establishing an “arbitrary, capricious, an[d] abuse of discretion” standard of review); 5 U.S.C. § 553(c) (requiring an agency to consider comments and provide a concise statement explaining the basis and purpose for a final rule when promulgating legislative rules).

11 *Motor Vehicle Mfrs. Ass’n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983) (requiring rules to be the product of reasoned decisionmaking).

12 Under the framework set forth in *Chevron*, agency regulations are entitled to deference unless they (1) contradict an unambiguous statute, or (2) adopt an unreasonable construction of it. *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). If a court determines that a statute is ambiguous under *Chevron* step-one, it generally gives “*Chevron* deference” to agency regulations under *Chevron* step-two unless they are arbitrary and capricious.

13 The Tax Court acknowledged that its past practice of referring “to regulations issued pursuant to specific grants of rulemaking authority as legislative regulations and regulations issued pursuant to Treasury’s general rulemaking authority, under sec. 7805(a), as interpretive regulations” was inconsistent with general administrative law use of the legislative and interpretive labels. *Altera*, 145 T.C. at 111, n.10. In the future it will refer to regulations issued pursuant to specific grants of rulemaking authority as specific authority regulations and regulations issued pursuant to Treasury’s general rulemaking authority, under IRC § 7805(a), as general authority regulations. *Id.* Under the reasoning of this decision, both specific authority and general authority regulations may be legislative regulations for purposes of the APA if they have the force of law, as discussed below.

14 5 U.S.C. §§ 553(b) and (c). An exception applies when the agency for “good cause” finds that the notice and comment process would be impracticable, unnecessary, or contrary to the public interest. 5 U.S.C. § 553(b). The government did not identify any such good cause in this instance.

15 *Id.*

16 *Altera*, 145 T.C. at 112-13 (citing *Motor Vehicle Mfrs. Ass’n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

17 *Id.*

18 The government argued that its regulations were based, in part, on the “commensurate-with-income” standard. Some have argued that they should have been upheld on that basis. See *Law Professors Urge Ninth Circuit to Uphold Cost-Sharing Reg.*, 2016 TNT 130-12 (July 7, 2016). However, the court did not sustain the regulations on that basis because the preamble to the regulations indicated that the standard it adopted was consistent with the arm’s-length standard. Under the arm’s-length standard the government was required to consider information about the costs that unrelated parties actually share, according to the court.

distinguish between high- and low-profit intangibles.<sup>19</sup> When the IRS later cited the administrative burden of such a distinction, the court discounted this as a speculative *post hoc* argument.<sup>20</sup> In other words, the government's conclusions had no basis in fact because it failed to engage in any fact finding.

The government's errors were not harmless. It was unclear that the government would have adopted the same rule if it had determined the inclusion of stock-based compensation was inconsistent with the arm's length standard. Moreover, the agency's failure to respond to comments frustrated the court's review and was prejudicial to affected entities.

The Tax Court also rejected the government's argument that the regulations were not subject to APA § 553(b). The APA does not require agencies to use the formal notice and comment process to promulgate "interpretative" rules, which include general statements of policy, or rules of agency organization, procedure, or practice.<sup>21</sup> However, "interpretive rules merely explain preexisting substantive law" and do not, themselves, have the force of law.<sup>22</sup> A rule is legislative if "Congress has delegated legislative power to the agency and if the agency intended to exercise that power in promulgating the rule."<sup>23</sup> Congress has expressly delegated such legislative power to Treasury pursuant to IRC § 7805(a).<sup>24</sup> Although the preamble to the 2003 regulation states that APA "section 553(b) ... does not apply to these regulations,"<sup>25</sup> the court inferred that the agency nonetheless intended to exercise its legislative power because (1) the regulation was necessary to sustain an adjustment to the taxpayer's income (*i.e.*, it had the force of law), and (2) Treasury expressly invoked general rulemaking authority under IRC § 7805(a) in promulgating it.<sup>26</sup>

This case is significant because it contradicts the IRS's assumption that most of its regulations are interpretive.<sup>27</sup> Rather, it suggests that most are legislative regulations that could be overturned if the government did not connect the facts to the final rule and provide a reasoned response to any comments under *State Farm's* reasoned decisionmaking standard. Other Treasury regulations are likely to be challenged on this basis, particularly in light of the fact that until 2014, the IRS's Chief Counsel Directives Manual (CCDM) stated that "[I]t is not necessary to justify the rules that are being proposed

19 *Altera*, 145 T.C. at 125.

20 *Id.* at 126. This analysis may suggest the court would have upheld the regulations if they had (1) required related parties to take stock-based compensation into account only with respect to high-profit intangibles, (2) had explained (and cited data to show) that it would be administratively difficult to distinguish between high- and low-profit intangibles, or (3) clearly explained that the government relied, *in the alternative*, on the "commensurate with income" standard with respect to the rule governing stock-based compensation.

21 5 U.S.C. § 553(b).

22 *Altera*, 145 T.C. at 111 (quotation omitted). While the IRS declined to brief this issue, it has taken the position that interpretive rules carry the force of law. *Altera*, 145 T.C. at 116. See also CCDM 32.1.5.4.7.5.1(10) (Sept. 30, 2011).

23 *Altera*, 145 T.C. at 111 (2015) (quoting *Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109 (D.C. Cir. 1993)).

24 *Altera*, 145 T.C. at 116. IRC § 7805(a) provides that "... the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."

25 68 Fed. Reg. 51171, 51177 (Aug. 26, 2003).

26 *Altera*, 145 T.C. at 115 (internal citations omitted).

27 See, e.g., CCDM 32.1.1.2.6 (Sept. 23, 2011); CCDM 32.1.5.4.7.5.1(2) (Sept. 30, 2011). For additional commentary on *Altera's* significance, see, e.g., Jerald August, *Altera: Why the Government Can't Count on Chevron Step Two*, 2016 TNT 109-9 (June 7, 2016). In addition, two groups of tax and administrative law professors filed amicus briefs in support of the government, which discuss significant policy concerns. See *Brief of Amici Curiae Anne Alstott et al.*, Dkt. Nos. 16-70496, 16-70497 (July 5, 2016), <http://ssrn.com/abstract=2805432>; *Brief of Amici Curiae J. Richard Harvey et al.*, Dkt. Nos. 16-70496, 16-70497 (July 1, 2016), <http://ssrn.com/abstract=2805663>.

or adopted or alternatives that were considered.”<sup>28</sup> The IRS and Treasury are reportedly making more effort to build the regulation file, explain decisions, respond to significant comments, and limit the issuance of temporary regulations.<sup>29</sup> These changes are consistent with the taxpayer *right to be informed*, illustrating how taxpayer rights reinforce what the APA requires.<sup>30</sup>

**In *Florida Bankers Assoc. v. United States Department of Treasury*, the United States Court of Appeals for the District of Columbia Circuit held the Anti-Injunction Act (AIA) barred a challenge to information reporting regulations.**<sup>31</sup>

In 2012, the Treasury Department issued final regulations (the 2012 Rule) requiring banks to report interest paid to certain nonresident aliens, even if the aliens were not subject to tax on the income in the U.S.<sup>32</sup> If a bank fails to report the interest, it is subject to a “penalty” under IRC § 6721(a). The Florida and Texas Bankers Associations challenged the 2012 Rule. The government argued, in part, that the AIA barred the court from hearing the case.<sup>33</sup>

By way of background, the Court of Appeals for the District of Columbia held in *Seven-Sky* that the AIA did not bar a pre-enforcement suit challenging the Affordable Care Act’s requirement that individuals obtain insurance (the “individual mandate”).<sup>34</sup> In *NFIB*, the Supreme Court agreed.<sup>35</sup> The D.C. Circuit also held in *Foodservice* that the AIA did not bar a pre-enforcement suit challenging regulations requiring food and beverage establishments to report amounts that their employees earned in tips.<sup>36</sup> Similarly, after oral argument in this case, the Supreme Court held in *Direct Marketing* that the Tax Injunction Act (TIA), a state analogue to the AIA, did not bar a pre-enforcement challenge to a Colorado law which required out-of-state retailers to report purchases by Colorado customers.<sup>37</sup>

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- 28 CCDM 32.1.5.4.7.3(1) (Sept. 30, 2011); CCDM 32.1.5.4.7.3(1) (Aug. 11, 2004) (same). See also Richard W. Skillman, *The Problems With Altera*, 2016 TNT 11-11 (Jan. 16, 2016) (“If a regulation can be invalidated because of a flaw or gap in its preamble explanation, it will be open season, and in some cases easy pickings, to challenge the validity of many tax regulations that have gone unchallenged for years.”). However, the IRS has recently removed the direction that regulation writers do not have to “justify the rules” (as quoted above). See CCDM 32.1.5.4.7.3(1) (Oct. 20, 2014). In addition, the IRS has long directed its attorneys to respond to comments received in response to proposed regulations. See, e.g., CCDM 32.1.5.4.7.3(3) (Oct. 20, 2014) (“The drafting team should explain why the agency found some comments persuasive, and others not, in issuing the final regulations.”); CCDM 32.1.5.4.7.3(2) (Sept. 30, 2011) (same); CCDM 32.1.5.4.7.3(2) (Aug. 11, 2004) (same).
- 29 Andrew Velarde, *Reg Process Could Get Slower and Less Stable*, *Wilkins Warns*, 2016 TNT 123-7 (June 27, 2016).
- 30 IRC § 780.
- 31 *Florida Bankers Assoc. v. U.S. Dep’t of Treasury*, 799 F.3d 1065 (D.C. Cir., 2015), *vacating and remanding* 19 F. Supp. 3d 111 (D.D.C. 2014), *reh’g en banc denied*, 116 A.F.T.R.2d (RIA) 6704 (D.C. Cir. 2015), *cert. denied*, No.15-969 (June 6, 2016).
- 32 T.D. 9584, 77 Fed. Reg. 23391 (Apr. 19, 2012) (promulgating Treas. Reg. § 1.6049-4(b)(5)(i)). The preamble to the regulations explained that the IRS needed this information so that it could provide reciprocal information to foreign countries pursuant to information exchange agreements.
- 33 IRC § 7421(a) (AIA) (taxpayers are precluded from filing suit for the purpose of restraining assessment or collection of any tax). As the Declaratory Judgment Act (28 U.S.C. § 2201) is generally interpreted as barring the same suits as the AIA (i.e., the statutes are “coterminous”), the courts did not analyze them separately and the Court of Appeals for the District of Columbia referred to both statutes as the AIA. This summary will use the same practice.
- 34 *Seven-Sky v. Holder*, 661 F.3d 1 (D.C. Cir. 2011), *cert. denied*, 133 S. Ct. 63 (2012), *abrogated on other grounds by Nat’l Fed’n of Indep. Bus. (NFIB) v. Sebelius*, 132 S. Ct. 2566 (2012).
- 35 *NFIB*, 132 S. Ct. at 2566.
- 36 *Foodservice & Lodging Inst, Inc. v. Regan*, 809 F.2d 842 (D.C. Cir. 1987).
- 37 *Direct Mktg. Ass’n v. Brohl*, 135 S. Ct. 1124 (2015). While *Direct Marketing* involved the Tax Injunction Act (TIA), 28 U.S.C. § 1341, which provides that federal district courts “shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law,” the Supreme Court interpreted it as applying the AIA to state taxes, explaining that “[I]n defining the terms of the TIA, we have looked to federal tax law as a guide. Although the TIA does not concern federal taxes, it was modeled on the Anti-Injunction Act (AIA), which does.” *Direct Mktg.*, 135 S. Ct. at 1129 (citations omitted).

The district court found the AIA inapplicable to the 2012 Rule because it only bars suits that would restrain the “assessment or collection of any tax.”<sup>38</sup> The court reasoned that this suit was to prevent implementation of reporting requirements before any tax (or penalty) had been incurred. Accordingly, the suit would not restrain the IRS from making an assessment because facts did not yet exist that would trigger a valid assessment.<sup>39</sup>

A three-judge panel of the D.C. Circuit reversed and remanded, holding the AIA barred the suit. The majority opinion by Circuit Judge Kavanaugh explained that while the AIA does not apply to suits involving tax-related regulatory requirements that are enforced by penalties, it does apply if the penalties are treated as taxes for purposes of the AIA. IRC § 6671(a) provides that the penalty under IRC § 6721(a) for a bank’s failure to comply with the reporting requirement is treated as a tax because it is located in Chapter 68, Subchapter B of the Tax Code. The D.C. Circuit focused on the Supreme Court’s explanation that, “[P]enalties in subchapter 68B” are “treated as taxes under Title 26, which includes the Anti-Injunction Act.”<sup>40</sup> The opinion distinguished *NFIB*, *Seven-Sky*, *Direct Marketing*, and *Foodservice* on the basis that the penalties in those cases were not treated as taxes for purposes of the AIA.<sup>41</sup>

The opinion also cited Supreme Court precedent indicating that an artfully drafted pleading, which challenges the regulatory aspects of a tax (e.g., in the context of tax-exempt entities or child labor taxes) cannot avoid the AIA if, as a result of the suit, the government would be restrained from collecting the tax.<sup>42</sup> If the AIA were inapplicable to the regulatory component of a tax, a taxpayer could characterize a challenge to a tax as a challenge to its regulatory components, reducing the AIA “to dust in the context of challenges to regulatory taxes,” according to the court.<sup>43</sup>

A strongly-worded dissent by Circuit Judge Henderson countered that the AIA does not bar a pre-enforcement challenge to regulatory requirements such as the 2012 Rule. First, the dissent argued that the literal language of the AIA does not bar suits just because they involve taxes; rather, they must also seek to “restrain the assessment or collection” thereof.<sup>44</sup> Suits that merely *inhibit* the assessment or collection of tax are not covered, as the Supreme Court noted in *Direct Marketing*.<sup>45</sup>

Second, an alternative basis for the holding that the AIA did not apply in *Seven-Sky* was that the plaintiff challenged the regulatory requirement and not the associated penalty.<sup>46</sup> Third, like the penalty for failure to purchase insurance in *Seven-Sky*, the penalty for failure to report payments to nonresident aliens does not implicate the purpose of the AIA to protect the government’s ability to “collect a consistent stream of revenue,” because a penalty is meant to deter violations of the underlying regulatory requirement

38 IRC § 7421(a). The district court went on to uphold the regulations. For prior discussion of this case, see National Taxpayer Advocate 2014 Annual Report to Congress 427, 439 (*Significant Cases*).

39 According to the district court, “[T]he D.C. Circuit has confirmed that [information] reporting requirements related to Chapter 61A of the Internal Revenue Code — as opposed to the associated penalties found in Chapter 68B — are not subject to the AIA....” *Florida Bankers*, 19 F. Supp.3d at 121 (citing *Foodservice and Lodging Inst., Inc.*, 809 F.2d at 842).

40 *Florida Bankers*, 799 F.3d at 1068 (quoting *NFIB*, 132 S. Ct. at 2583).

41 It indicated the penalty at issue in *Foodservice* was under IRC § 6652, which is in Subchapter A.

42 See, e.g., *Bailey v. George*, 259 U.S. 16 (1922) (child labor tax); *Alexander v. “Americans United” Inc.*, 416 U.S. 752 (1974) (tax exemption); *Bob Jones University v. Simon*, 416 U.S. 725 (1974) (tax exemption).

43 *Florida Bankers*, 799 F.3d at 1071.

44 See *id.* at 1075 n.26.

45 See *id.* at 1076 n.33.

46 Circuit Judge Randolph’s concurring opinion disagrees with the dissent’s characterization of *Seven-Sky*, asserting that the AIA would have applied in *Seven-Sky* if the penalty at issue was a tax within the meaning of the AIA. *Florida Bankers*, 799 F.3d at 1072.



rather than raise revenue.<sup>47</sup> Fourth, the penalty at issue in *Foodservice* was the same one at issue in this case (IRC § 6721), though Congress attached the tax penalty to the tip-reporting requirement after oral argument in *Foodservice* (but three months before the decision). Finally, if a bank cannot obtain preenforcement review of the 2012 Rule then it may only obtain review by incurring a penalty and initiating a refund suit, while risking penalties and imprisonment for willful failure to file under IRC § 7203.<sup>48</sup> Such a precondition would present constitutional concerns, according to the dissent.

This case is significant because it illustrates the continuing confusion about the scope of the AIA as applied to penalties for failure to comply with regulatory requirements.<sup>49</sup> Clarity in this area is increasingly important, as Congress has turned to the IRS to administer social programs and regulatory requirements.

**In *Z Street, Inc. v Koskinen*, the United States District Court of Appeals for the District of Columbia Circuit held the AIA did not bar a suit alleging the IRS improperly scrutinized and delayed applications for tax exemption from organizations with certain political views.**<sup>50</sup>

About eight months after Z Street applied for tax-exempt status under IRC § 501(c)(3), it filed suit under the Declaratory Judgment Act, 28 U.S.C. § 2201, alleging the IRS had delayed processing its application due to the special scrutiny it was applying to organizations holding certain political views (the “Israel Special Policy”), in violation of the First Amendment. The IRS moved to dismiss, arguing that the action was barred by the AIA, which prohibits suits to “restrain the assessment or collection of any tax,” and that Z Street had adequate remedies at law. For example, if the IRS did not act on the application within 270 days (only 32 more days), Z Street could sue for a declaratory judgment under IRC § 7428, or it could obtain judicial review by waiting for the IRS to issue a statutory notice of deficiency (SNOD) and then file a petition with the U.S. Tax Court (under IRC § 6213), or it could pay the tax and file a refund suit in a U.S. district court or the U.S. Court of Federal Claims (under IRC § 7422).

The district court denied the IRS’s motion and the United States District Court of Appeals for the District of Columbia Circuit affirmed.<sup>51</sup> For purposes of the motion, the D.C. Circuit assumed Z Street’s allegation of improper discrimination was true. The court explained that the AIA does not apply in situations where the plaintiff has no alternative means to challenge the IRS’s actions. It reasoned that although Z Street could potentially obtain judicial review of its exemption status under IRC §§ 7428, 6213, or 7422, a review under those provisions would not address Z Street’s alleged injury — special scrutiny and delay resulting from the Israel Special Policy. Because application of the AIA would leave Z Street with no alternative means to challenge the Israel Special Policy, it did not bar the suit.

<sup>47</sup> *Florida Bankers*, 799 F.3d at 1078 (internal citations omitted).

<sup>48</sup> *Florida Bankers* elaborated in its petition to the Supreme Court that banks do not have the option of violating the rule in order to challenge it because many of them could lose their Federal Deposit Insurance Act coverage and, thus, their ability to do business if they incurred a criminal penalty like the one imposed for violation of the reporting regulation. *Florida Bankers*, 2016 WL 369508, No. 15-969 (Jan. 29, 2016) (petition for writ of cert.). The Supreme Court denied certiorari. *Florida Bankers Assoc. v. U.S. Dep’t of Treasury*, 136 S. Ct. 2429 (2016).

<sup>49</sup> The Chief Counsel for the IRS has reportedly expressed concern, that “arguments are seriously being put forth in support of the proposition that the Anti-Injunction Act is toothless to forestall out-of-box regulation challenges by interest groups that do not have an actual controversy.” Andrew Velarde, *Reg Process Could Get Slower and Less Stable, Wilkins Warns*, 2016 TNT 123-7 (June 27, 2016).

<sup>50</sup> *Z Street, Inc. v Koskinen*, 791 F.3d 24 (D.C. Cir. 2015).

<sup>51</sup> *Id.* at 32, *aff’d* 44 F. Supp.3d 48 (D.D.C. 2014).

This case is significant because it suggests that judicial review is more likely to be available to plaintiffs who allege that an IRS process has systemic flaws that would not otherwise be subject to judicial review. If so, it may increase judicial oversight of the IRS's procedures.

**In *Dorrance v. United States*, the United States Court of Appeals for the Ninth Circuit held taxpayers had no basis in stock received upon demutualization of their insurance carrier.<sup>52</sup>**

Mr. and Mrs. Dorrance purchased life insurance policies from mutual insurance companies. Mutual insurance companies are owned by policyholders, not stockholders. They return any surplus (profits) to policyholders in the form of dividends. Policyholders also have certain mutual rights normally held by stockholders, such as the right to vote and the right to receive the mutual company's surplus if it liquidates.

In transactions qualifying as tax-free re-organizations, each of the insurance companies demutualized, distributing shares of stock to policyholders in exchange for their mutual rights. When the Dorrances sold their stock, they reported the proceeds as gain, paid the resulting tax, and then filed for a refund, claiming the sale produced no gain. They argued the sale did not generate gain because the stock represented a return of previously-paid policy premiums. In the alternative, they argued their membership rights were not capable of valuation, and therefore, their premium payments should have been counted toward their basis in the stock under the open transaction doctrine.<sup>53</sup> This was the approach adopted in 2008 by the Court of Federal Claims in *Fisher*.<sup>54</sup> The IRS denied the claim, arguing that the Dorrances had no basis in the stock because they did not prove they had paid anything for the membership rights (and thus the stock).

The district court rejected both parties' positions and, after a bench trial, held that the stock had a basis equal to its value minus the amount of the Dorrances' projected future contributions to surplus under the policies.<sup>55</sup> Both parties appealed. The United States Court of Appeals for the Ninth Circuit agreed with the IRS. It determined the Dorrances acquired the membership rights at no cost. Accordingly, the Dorrances' stock basis was zero.

This case is significant because the IRS is likely to deny claims it had suspended. Following the *Fisher* decision, taxpayers made protective claims for refunds of taxes paid on the sale of stock received in connection with demutualizations. The IRS sometimes responded by indicating it would hold those claims in abeyance pending resolution of *Dorrance*.<sup>56</sup> As a result of this case, the IRS will reject the claims, potentially generating additional litigation in this area.

52 *Dorrance v. United States*, 809 F.3d 479 (9th Cir. 2015). For prior coverage of the issues in this case, see National Taxpayer Advocate 2013 Annual Report to Congress 326, 336 (discussing the district court opinion); National Taxpayer Advocate 2008 Annual Report to Congress 468-469 (discussing *Fisher v. United States*, 82 Fed. Cl. 780 (2008), *aff'd without opinion*, 333 F. App'x 572 (Fed. Cir. 2009), which held the open transaction doctrine applied to the sale of stock received in connection with a demutualization).

53 Under this doctrine the transaction would remain open (i.e., basis may be adjusted, but gain or loss is deferred) until the Dorrances dispose of the stock. See *Fisher v. United States*, 82 Fed. Cl. 780 (2008), *aff'd without opinion*, 333 F. App'x 572 (Fed. Cir. 2009).

54 *Id.* Although the IRS has not issued an AOD, it disagrees with *Fisher*. See *Cadreja v. United States*, 104 Fed. Cl. 296 (2012); *Reuben v. United States*, 111 A.F.T.R.2d (RIA) 620 (D. Cal. 2013), *rev'd*, 628 F. App'x 509 (9th Cir. 2016); Letter from IRS Associate Chief Counsel (Income Tax & Accounting) to Senator Harkin (May 23, 2011), *reprinted as, IRS Will Not Refund Tax Paid on Sale of Life Insurance Company Stock*, 2011 TNT 180-28 (Sept. 16, 2011).

55 *Dorrance v. United States*, 877 F. Supp.2d 827 (D. Ariz. 2012).

56 Memorandum for Technical Services Territory Managers, from Director, Technical Services, *Guidance for Demutualization Claims* (Aug. 24, 2009).

**In *Ibrahim v. Commissioner*, the United States Court of Appeals for the Eighth Circuit held that a taxpayer could file jointly even after filing as head of household and timely petitioning the Tax Court.<sup>57</sup>**

Mr. Ibrahim and his wife, both immigrants who spoke little English, filed their 2011 tax returns with assistance from Oday Tax Service. Mr. Ibrahim claimed head of household (HOH) filing status, which was improper because he was married and living with his wife. The IRS sent a timely SNOD to Mr. Ibrahim, asserting he should be taxed at the higher rate applicable to those who are married filing separately (MFS). After filing a petition with the Tax Court to challenge the deficiency, Mr. Ibrahim and his wife sought to amend their returns by electing married filing jointly (MFJ) status and claiming the earned income tax credit (EITC) along with other tax benefits.<sup>58</sup> The IRS argued that after filing his petition, Mr. Ibrahim was no longer eligible for MFJ status.

IRC § 6013(b)(2)(B) specifically bars a taxpayer from electing MFJ status after filing a “separate return” if either spouse has received a SNOD and filed a timely petition with the Tax Court. In *Glaze*, the Fifth Circuit Court of Appeals held that the term “separate return” in IRC § 6013(b) means only a return electing MFS status, and not any other filing status, including HOH.<sup>59</sup> The Court of Appeals for the Eleventh Circuit follows the reasoning in *Glaze*.<sup>60</sup> The Tax Court, however, interprets the term “separate return” to mean any return except for a MFJ return.<sup>61</sup> Although the IRS follows *Glaze* in cases appealable to the Fifth and Eleventh Circuits under the *Golsen* rule, it does not do so in other cases.<sup>62</sup> Because this case was appealable to the Eighth Circuit, the Tax Court held that IRC § 6013(b)(2) barred Mr. Ibrahim and his wife from amending their returns to elect MFJ filing status.<sup>63</sup>

The United States Court of Appeals for the Eighth Circuit reversed.<sup>64</sup> It concluded that the term “separate return” as used in IRC § 6013(b) applies only to a MFS return and not an HOH return. Thus, Mr. Ibrahim was permitted amend his return to file as MFJ.

This case is significant because it highlights the inconsistent interpretation of IRC § 6013(b)(2)(B) by the courts. The National Taxpayer Advocate has recommended legislation that would allow all taxpayers to change their filing status, regardless of which circuit court would hear their appeal.<sup>65</sup>

**In *Voss v. Comm’r*, the United States Court of Appeals for the Ninth Circuit held that the mortgage interest deduction limits apply on a per-taxpayer (not per-residence) basis.<sup>66</sup>**

Bruce Voss and Charles Sophy, unmarried joint owners of two homes, each claimed a home mortgage interest deduction in excess of the statutory limit. For taxpayers other than married individuals filing

<sup>57</sup> *Ibrahim v. Comm’r*, 788 F.3d 834 (8th Cir. 2015).

<sup>58</sup> To be considered eligible for the EITC, a married taxpayer must file a joint return. IRC § 32(d).

<sup>59</sup> *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981).

<sup>60</sup> *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981) (adopting all prior decisions of the Court of Appeals for the Fifth Circuit).

<sup>61</sup> See, e.g., *Currie v. Comm’r*, T.C. Memo. 1986–71; *Blumenthal v. Comm’r*, T.C. Memo. 1983–737; *Saniewski v. Comm’r*, T.C. Memo. 1979–337.

<sup>62</sup> See *Golsen v. Comm’r*, 54 T.C. 742, 757 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971). See also *Glaze*, 641 F.2d at 339, *action on dec.*, 1981-140 (June 2, 1981); Chief Counsel Notice CC-2006-010 (Mar. 2, 2006).

<sup>63</sup> *Ibrahim v. Comm’r*, T.C. Memo. 2014-8.

<sup>64</sup> *Ibrahim*, 788 F.3d at 841.

<sup>65</sup> See National Taxpayer Advocate 2014, Annual Report to Congress 346-350 (Legislative Recommendation: Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure).

<sup>66</sup> *Voss v. Comm’r*, 796 F.3d 1051 (9th Cir. 2015), *rev’g* 138 T.C. 204 (2012).

a separate return, IRC § 163(h)(3) limits the deduction for interest to \$1 million of home acquisition debt and \$100,000 of home equity debt on a qualified residence. If the limits apply to each taxpayer, then two unmarried taxpayers could deduct interest on up to \$2.2 million of debt. If the limits apply to a qualifying residence, two co-owners could only deduct interest on up to \$1.1 million of debt (assuming they do not own other qualifying residences). After an audit, the IRS disallowed a portion of their mortgage interest deductions, arguing that the limits apply on a per-residence basis. The taxpayers challenged the IRS's assessment in the Tax Court, arguing that the statute's limits apply on a per-taxpayer basis. The Tax Court agreed with the IRS, but a majority of the United States Court of Appeals for the Ninth Circuit agreed with the taxpayers.

The United States Court of Appeals for the Ninth Circuit focused on the parentheticals in IRC § 163(h)(3)(B)(ii) and (C)(ii) that halve the debt ceilings (*i.e.*, reduce them to \$550,000) “in the case” of a married individual filing a separate return. It explained that by doing so, “Congress implied that unmarried co-owners filing separate returns are entitled to deduct interest on up to \$1.1 million of home debt each.”<sup>67</sup> While this created a marriage penalty, the court observed that was Congress's decision.<sup>68</sup> It also pointed out that applying a per-residence ceiling would be unworkable in situations where two or more unmarried taxpayers each had an individual primary residence and also co-owned a secondary residence, which were in each case, qualified residences.<sup>69</sup>

This case is significant because unless the IRS acquiesces in the result, unmarried taxpayers in different circuits may be subject to different mortgage interest deduction limits. Specifically, the Tax Court may continue to apply the limits on mortgage interest deductions on a per-residence basis under the *Golsen* rule (discussed above),<sup>70</sup> but apply it on a per-taxpayer basis for cases appealable to the Ninth Circuit.

**In *United States v. Norcal Tea Party Patriots*, the United States Court of Appeals for the Sixth Circuit held the names, addresses, and taxpayer identification numbers of applicants for tax-exempt status do not constitute “return information” under IRC § 6103(b)(2)(A).**<sup>71</sup>

The Norcal Tea Party Patriots filed suit seeking to certify a class of organizations whose applications for tax exemption were allegedly targeted by the IRS for special scrutiny. They sought to discover fellow members of the putative class that were on the IRS's “Be on the Lookout” (BOLO) list.<sup>72</sup> The IRS argued that any information contained in an application for tax-exempt status, including the applicant's name, is confidential “return information” that is barred from disclosure under IRC § 6103.

<sup>67</sup> Voss, 796 F.3d at 1068.

<sup>68</sup> *Id.* at 1065. The court was unpersuaded by the analysis of CCA 200911007 (Mar. 13, 2009), which concluded that unmarried co-owners are limited to \$1,000,000 of total, aggregate acquisition indebtedness.

<sup>69</sup> Voss, 796 F.3d at 1064 (“For example, two individuals might each have a separate primary residence but go in together on a vacation home in Maui. For such co-owners, filing tax returns under the Tax Court's per-residence approach would be like running a three-legged race. The co-owners are tied together for one home but not the other. This would mean that the two (or it could be three or four) co-owners would have to coordinate their tax returns to ensure that the aggregate amount of acquisition debt for each taxpayer's ‘qualified residence’ does not exceed \$1 million. It would also mean that one co-owner's deduction might depend on the size of another co-owner's mortgage on a home in which the first co-owner has no interest.”).

<sup>70</sup> See *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

<sup>71</sup> *United States v. NorCal Tea Party Patriots*, 817 F.3d 953 (6th Cir. 2016).

<sup>72</sup> For more information about the BOLO list, see *National Taxpayer Advocate Special Report to Congress: Political Activity and the Rights of Applicants for Tax-Exempt Status* and Treasury Inspector General for Tax Administration (TIIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013).

The district court agreed that the plaintiffs' requests encompassed "return information," but held that the IRS could disclose the documents under IRC § 6103(h)(4)(B), which permits disclosure where "the treatment of an item reflected on such return is directly related to the resolution of an issue" in a judicial proceeding.<sup>73</sup> The district court ordered the IRS to produce the documents, but permitted the IRS to redact employer identification numbers. The IRS filed a petition for a *writ of mandamus*, arguing that IRC § 6103(h)(4)(B) did not apply.<sup>74</sup> According to the IRS, IRC § 6103(h)(4)(B) authorizes disclosure only of information reflected on a return. It argued that because names on a BOLO list are return *information*, which is not reflected on a return, they may not be disclosed pursuant to IRC § 6103(h)(4)(B).

The United States Court of Appeals for the Sixth Circuit agreed with the IRS that IRC § 6103(h)(4)(B) only authorizes disclosure of information reflected on a return and not all return information. However, it ordered the IRS to disclose the names on the BOLO list because it concluded they are neither information on returns nor return information. The court reasoned that "return information" as defined by IRC § 6103(b)(2)(A) includes "a taxpayer's identity," which means the name of a person with respect to whom a return is filed. Because an application for exemption is not a return, the name of an applicant for tax-exemption is not a "taxpayer's identity" as that term is defined in IRC § 6103(b)(6) and used in IRC § 6103(b)(2)(A).<sup>75</sup>

The court also rejected the IRS's argument that the names of applicants for tax-exempt status are return information under IRC § 6103(b)(2)(A) because the names are "other data ... with respect to the determination of the existence, or possible existence, of liability" for a tax. The court reasoned that if "data collected" includes the name of an applicant for tax-exempt status, then it also includes the name of a taxpayer who files a return. But, if that were true, then Congress was wasting its time when it included "taxpayer identity" as a type of return information under IRC § 6103(b)(2)(A), because a taxpayer's name would already be "data collected" (and thus return information) under the IRS's interpretation of that term.

This case is significant because it holds that "the names, addresses, and taxpayer-identification numbers of applicants for tax-exempt status are not 'return information' under IRC § 6103(b)(2)(A)."<sup>76</sup> As a result, it appears that such information may be disclosed to the public, even if tax-exempt status is not granted.<sup>77</sup>

**In *Peterson v. Commissioner*, the United States Court of Appeals for the Eleventh Circuit held that a payee was bound to report payments as provided by a contract that was unilaterally amended by the payor.<sup>78</sup>**

Mrs. Peterson was an independent contractor for Mary Kay who reached the highest level of its sales network to become a National Sales Director (NSD). She earned commissions on wholesale purchases of

<sup>73</sup> *NorCal Tea Party Patriots v. I.R.S.*, 114 A.F.T.R.2d (RIA) 5358 (S.D. Ohio 2014).

<sup>74</sup> A writ of *mandamus* is an extraordinary remedy whereby a court may order an inferior court or government official to fulfill their official duties or correct an abuse of discretion. See, e.g., *Cheney v. United States Dist. Court*, 542 U.S. 367, 380 (2004) (explaining a writ of *mandamus* is only appropriate in "exceptional circumstances amounting to a judicial usurpation of power, or a clear abuse of discretion...") (internal citations omitted).

<sup>75</sup> The court did not discuss the broad interpretation applied to the term "taxpayer" in other circumstances. See, e.g., *U.S. v. Williams*, 514 U.S. 527, 529 (1995) (concluding that a "taxpayer" includes someone who pays the tax of another).

<sup>76</sup> *NorCal Tea Party Patriots*, 817 F.3d at 965.

<sup>77</sup> See, e.g., Lloyd Hitoshi Mayer, *NorCal Tea Party Patriots Opens a Crack in Taxpayer Privacy Protections* (June 2016), [http://www.americanbar.org/content/dam/aba/publishing/aba\\_tax\\_times/16jun/att-16jun-005-at-court-norcal-tea-party-patriots-mayer.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/aba_tax_times/16jun/att-16jun-005-at-court-norcal-tea-party-patriots-mayer.authcheckdam.pdf) (concluding the decision appears to "open the door for interested parties to seek disclosure, both in litigation and through FOIA requests, of documents listing applicants for recognition of exemption").

<sup>78</sup> *Peterson v. Comm'r*, 117 A.F.T.R.2d (RIA) 1815 (11th Cir. 2016).



Mary Kay products by her network of independent beauty consultants, sales directors, and other NSDs. As an NSD, Mrs. Peterson became eligible for two non-employee retirement programs, the Family Security Program (FSP) and the Great (or Global) Futures Program (GFP). Payments under the FSP and GFP were based on her pre-retirement commissions in the United States and the post-retirement wholesale purchases by her international network, respectively. In exchange for payments under the programs, Mrs. Peterson agreed to retire (*i.e.*, sever her NSD agreement and cease earning regular commissions) at a certain age and not to compete with Mary Kay.

The FSP and GFP agreements, which Mrs. Peterson signed in 1992 and 2005, respectively, did not address the character of the program payments. However, Mary Kay retained the right to terminate or modify them at any time. In 2008, immediately before Mrs. Peterson retired, Mary Kay unilaterally modified them to clarify that the payments were deferred compensation. According to Mary Kay, it modified the agreements to ensure the programs complied with the requirements of IRC § 409A.<sup>79</sup> When Mrs. Peterson retired and received payments under the FSP and GFP, she took the position that they were for the sale of her business and her covenant not to compete. She argued they were not deferred compensation, which would be subject to self-employment tax. Self-employment tax is only due on income “derived by an individual from any trade or business carried on by such individual.”<sup>80</sup> It is not due on the sale of a business.

The IRS determined the FSP and GFP payments were subject to self-employment tax. Both the Tax Court and the U.S. Court of Appeals for the Eleventh Circuit agreed. According to the Tax Court, the FSP and GFP payments were “derived” from Mrs. Peterson’s prior labor. The payments would only be made after a minimum number of years of service and were based on her pre-retirement commissions and the post-retirement wholesale volume of her network (*i.e.*, how well the network performed based on her prior services), respectively.<sup>81</sup> The Tax Court also noted that the FSP and the GFP agreements, as amended, expressly provided that the distributions were deferred compensation (*i.e.*, related to Mrs. Peterson’s prior labor) and Mrs. Peterson had not shown they were unenforceable. It cited *Comm’r v. Danielson*, which established the so-called *Danielson* rule that unless a contract is unenforceable, a taxpayer generally cannot use substance-over-form principles to disavow the form of a transaction that he or she agreed to.<sup>82</sup>

Relying on the *Danielson* rule, a majority of an Eleventh Circuit panel affirmed. The majority was not concerned that Mary Kay had unilaterally amended the program agreements to characterize the payments solely for tax purposes, or that it did so immediately before Mrs. Peterson retired.<sup>83</sup> It reasoned that when Mrs. Peterson agreed to allow Mary Kay to make unilateral modifications to the agreements, she implicitly agreed to Mary Kay’s characterization of the payments under them. A dissenting opinion

79 IRC § 409A generally provides that participants in a nonqualified deferred compensation plan that fails to satisfy certain requirements are immediately subject to current taxation, plus interest, on all compensation deferred under the plan. It also imposes an additional 20 percent tax on certain non-complying compensation. Mary Kay claimed it had always viewed the payments under the plans as deferred compensation (deductible by Mary Kay) and made the amendments to protect participating NSDs from the consequences of not complying with IRC § 409A.

80 IRC § 1402(a).

81 *Peterson v. Comm’r*, T.C. Memo. 2013-271.

82 *Id.* (citing *Plante v. Comm’r*, 168 F.3d 1279, 1280-1281 (11th Cir. 1999), and *Comm’r v. Danielson*, 378 F.2d 771, 775 (3d Cir. 1967)).

83 In some circumstances, however, the timing of a unilateral contract modification can support a finding of bad faith, which can make the modification unenforceable. See, e.g., Earle K. Shawe and Mark J. Swerdlin, *You Promised! - May an Employer Cancel or Modify Employee Severance Pay Arrangements?*, 44 Md. L. Rev. 903 (1985), <http://digitalcommons.law.umaryland.edu/mlr/vol44/iss3/6>.



by Judge Rosenbaum (concurring in part) observed that the agreements Mrs. Peterson signed did not characterize the payments as deferred compensation. The dissenting opinion takes “issue with the Majority’s second-order conclusion that Peterson’s consent to unilateral amendments *to the Programs* somehow permitted Mary Kay to bind Peterson to its post-hoc characterization of the Program payments for purposes of applying the judicially crafted *Danielson* rule.”<sup>84</sup> One rationale for the *Danielson* rule is to prevent a party from unjustly enriching itself by unilaterally altering the intended tax consequences of a transaction after consummation.<sup>85</sup> The dissent argues that applying the *Danielson* rule in circumstances like these — where the contract was unilaterally modified by one party after execution by the other — actually incentivizes parties to engage in the very post-hoc tax liability shifting that the rule is meant to guard against.<sup>86</sup>

While another rationale for the rule is to prevent the IRS from having to pursue a taxpayer’s counterparty in whipsaw litigation in a particular set of cases, the dissent argues this is not one of those cases. Because no prior court has applied the *Danielson* rule in situations where one party unilaterally modified the contract after execution by the other, the majority’s conclusion does not prevent unnecessary whipsaw litigation. Rather, it prevents necessary whipsaw litigation, according to the dissent.

After concluding that the payments were not deferred compensation, the dissent agreed with the majority’s conclusion that the FSP payments were subject to self-employment tax. They had sufficient nexus to the quality of Ms. Peterson’s prior work for Mary Kay. However, the dissent concluded that the GFP payments were not subject to self-employment tax. It reasoned they were based on the quality of work subsequently performed by members of Mrs. Peterson’s network, and thus, lacked sufficient nexus to the quality of her work.

This case is significant to the extent it expands the scope of the *Danielson* rule.<sup>87</sup> It may suggest that one party to a contract may require another party to characterize a transaction in a way not contemplated at the outset, provided he or she has enough bargaining power and foresight to obtain the right to make unilateral modifications.<sup>88</sup> Although the unilateral modification of a contract can render it unenforceable, such provisions are not uncommon in the context of employment contracts.<sup>89</sup> As workers are increasingly

84 *Peterson v. Comm’r*, 117 A.F.T.R.2d (RIA) 1815 (11th Cir. 2016).

85 The majority observes that Mary Kay was not enriched because its amendment was to clarify the characterization of the programs, as it had always intended to deduct payments under them. If the transaction were properly characterized as Mary Kay’s purchase of Mrs. Peterson’s business or her goodwill under the non-compete, however, the dissent points out that its payments would not have been fully deductible.

86 A related function of the *Danielson* rule is to promote certainty. However, permitting one party to bind the other to a new tax treatment of a transaction after execution of the agreement could result in less certainty, according to the dissent.

87 Litigation over application of the *Danielson* rule may have abated in recent years due to its partial codification. See IRC §1060(a)(flush) (“If in connection with an applicable asset acquisition, the transferee and transferor agree in writing as to the allocation of any consideration, or as to the fair market value of any of the assets, such agreement shall be binding on both the transferee and transferor unless the Secretary determines that such allocation (or fair market value) is not appropriate.”).

88 The majority’s holding could possibly be distinguished from other cases on the basis that Mrs. Peterson implicitly ratified the unilateral modification through her actions because she did not object when informed of the modification. She may have thought that protesting would be fruitless, however, because Mary Kay did not negotiate and tailor the program terms for her. *Peterson*, 117 A.F.T.R.2d (RIA) at n.29 (“Neither standard Program agreement was personalized for Peterson...”).

89 See, e.g., Michael L. DeMichele and Richard A. Bales, *Unilateral-Modification Provisions in Employment Arbitration Agreements*, 24 HOFSTRA LAB. & EMP. L.J. 63 (Fall 2006).

hired as independent contractors rather than employees,<sup>90</sup> unilateral modification provisions may find their way into more contracts with non-employees.

**In *May v. United States*, the United States District Court for the District of Arizona held the IRS’s receipt of “information” triggered the limitations period for assessing the penalty under IRC § 6707A for failure to report a listed transaction, even though the taxpayer did not file the proper form.<sup>91</sup>**

More than a year after Mr. May disclosed information about a listed transaction to the IRS, it assessed a penalty against him under IRC § 6707A for failing to disclose the transaction on Form 8886, *Reportable Transaction Disclosure Statement*. Mr. May had executed two timely Forms 872, *Consent to Extend the Time to Assess Tax*. One extended the limitations period for income and excise taxes for tax years (TYs) 2003 and 2004. Another extended the limitations period for IRC § 6707A penalties for TYs 2005 and 2006, but not 2004. Mr. May paid the penalty, submitted a claim for refund, and filed suit on the basis that the penalty was time barred as to 2004.

Under IRC § 6501(c)(10), the IRS must assess the IRC § 6707A penalty within one year after the earlier of “(A) the date on which the Secretary is furnished the information so required, or (B) the date that a material advisor” provides the same information. The government argued that only the filing of Form 8886, and not the mere delivery of “information,” triggers the running of the statute of limitations period.<sup>92</sup> Even if the period would normally have expired, the government argued that Mr. May extended it by signing Form 872, which covered all “income and excise taxes” for 2004. According to the government, the word “tax” on Form 872 included additions to tax and penalties, such as the IRC § 6707A penalty.

The court first concluded that under the plain language of the statute, it is the furnishing of information, and not the submission of a particular form, that starts the limitations period. Next, the court concluded that the Form 872 covering 2004 extended the period for assessing tax, but not the IRC § 6707A penalty. Based on the parties’ conduct and testimony, the court found they only intended the Forms 872 to extend the period for assessing the IRC § 6707A penalty when they specifically referenced that penalty. The only Form 872 applicable to 2004 did not specifically cover the IRC § 6707A penalty. Thus, the IRS’s assessment was time barred.

This case is significant because it suggests the one-year limitations period for assessing a penalty for failure to report a listed transaction begins when someone provides information about the transaction to the IRS, even if someone other than the taxpayer does so and even if the information is not provided on Form 8886. The case is also significant to the extent it suggests that Forms 872 covering “taxes” do not automatically cover penalties, particularly if the IRS’s practice is to address penalties by specifically referencing them on separate Forms 872.

90 See, e.g., *The Sharing Economy: A Taxing Experience for New Entrepreneurs: Hearing Before the H. Comm. on Small Business*, 114th Cong. (2016) (statement of Nina E. Olson, National Taxpayer Advocate), [https://www.irs.gov/pub/tas/nta\\_written\\_testimony\\_the\\_sharing\\_economy\\_5\\_26\\_2016.pdf](https://www.irs.gov/pub/tas/nta_written_testimony_the_sharing_economy_5_26_2016.pdf).

91 *May v. United States*, 115 A.F.T.R.2d (RIA) 2155 (D. Ariz. 2015).

92 See, e.g., Treas. Reg. § 1.6011-4(d) (“If the form is not completed in accordance with the provisions in this paragraph (d) and the instructions to the form, the taxpayer will not be considered to have complied with the disclosure requirements of this section.”).

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## Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

## SUMMARY

Internal Revenue Code (IRC) § 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations causes an underpayment of tax required to be shown on a return, or if an underpayment exceeds a computational threshold called a substantial understatement, respectively. IRC § 6662(b) also authorizes the IRS to impose the accuracy-related penalty on an underpayment of tax in six other circumstances.<sup>1</sup>

TAXPAYER RIGHTS IMPACTED<sup>2</sup>

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

## PRESENT LAW

The amount of an accuracy-related penalty equals 20 percent of the portion of the underpayment attributable to the taxpayer's negligence or disregard of rules or regulations, or to a substantial understatement.<sup>3</sup> An underpayment is the amount by which any tax imposed by the IRC exceeds the excess of:

The sum of (A) the amount shown as the tax by the taxpayer on his return, plus (B) amounts not shown on the return but previously assessed (or collected without assessment), over the amount of rebates made.<sup>4</sup>

In computing the amount of underpayment for accuracy-related penalty purposes, Congress changed the law in 2015 to provide that the excess of refundable credits over the tax is taken into account as a negative

<sup>1</sup> Internal Revenue Code (IRC) § 6662(b)(3) authorizes a penalty for any substantial valuation misstatement under chapter 1 (IRC §§ 1-1400U-3); IRC § 6662(b)(4) authorizes a penalty for any substantial overstatement of pension liabilities; IRC § 6662(b)(5) authorizes a penalty for any substantial valuation understatement of estate or gift tax; IRC § 6662(b)(6) authorizes a penalty when the IRS disallows the tax benefits claimed by the taxpayer when the transaction lacks economic substance; IRC § 6662(b)(7) authorizes a penalty for any undisclosed foreign financial asset understatement; and IRC § 6662(b)(8) authorizes a penalty for any inconsistent estate basis. IRC § 6662(b)(8) was added by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, § 2004(c), 129 Stat. 443, 456 (2015). We have chosen not to cover the IRC §§ 6662(b)(3)-(8) penalties in this report, as these penalties were not litigated nearly as much as IRC §§ 6662(b)(1) and 6662(b)(2) during the period we reviewed.

<sup>2</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the IRC. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

<sup>3</sup> IRC § 6662(b)(1) (negligence/disregard of rules or regulations); IRC § 6662(b)(2) (substantial understatement of income tax).

<sup>4</sup> IRC § 6664(a).

amount.<sup>5</sup> Therefore, for returns filed after December 18, 2015, or for returns filed on or before that date for which the period of limitations on assessment under IRC § 6501 has not expired, a taxpayer can be subject to an IRC § 6662 underpayment penalty based on a refundable credit which reduces tax below zero.

The IRS may assess penalties under IRC § 6662(b)(1) and 6662(b)(2), but the total penalty rate generally cannot exceed 20 percent (*i.e.*, the penalties are not “stackable”).<sup>6</sup> Generally, taxpayers are not subject to the accuracy-related penalty if they establish that they had reasonable cause for the underpayment and acted in good faith.<sup>7</sup> In addition, a taxpayer will be subject to the negligence component of the penalty only on the portion of the underpayment attributable to negligence. If a taxpayer wrongly reports multiple sources of income, for example, some errors may be justifiable mistakes, while others might be the result of negligence; the penalty applies only to the latter.

### Negligence

The IRS may impose the IRC § 6662(b)(1) negligence penalty if it concludes that a taxpayer’s negligence or disregard of the rules or regulations caused the underpayment. Negligence is defined to include “any failure to make a reasonable attempt to comply with the provisions of this title, and the term ‘disregard’ includes any careless, reckless, or intentional disregard.”<sup>8</sup> Negligence includes a failure to keep adequate books and records or to substantiate items that give rise to the underpayment.<sup>9</sup> Strong indicators of negligence include instances where a taxpayer failed to report income on a tax return that a payor reported on an information return,<sup>10</sup> as defined in IRC § 6724(d)(1),<sup>11</sup> or failed to make a reasonable attempt to ascertain the correctness of a deduction, credit, or exclusion.<sup>12</sup> The IRS can also consider various other factors in determining whether the taxpayer’s actions were negligent.<sup>13</sup>

### Substantial Understatement

Generally, an “understatement” is the difference between (1) the correct amount of tax and (2) the tax reported on the return, reduced by any rebate.<sup>14</sup> Understatements are reduced by the portion attributable to (1) an item for which the taxpayer had substantial authority or (2) any item for which the taxpayer, in the return or an attached statement, adequately disclosed the relevant facts affecting the

5 IRC § 6664(a). Prior to December 18, 2015, refundable credits could not reduce below zero the amount shown as tax by the taxpayer on a return. See *Rand v. Comm’r*, 141 T.C. 376 (2013). On December 18, 2015, Congress enacted a law that reversed the Tax Court’s decision in *Rand* and amended IRC § 6664(a) to be consistent with the rule of IRC § 6211(b)(4). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 209, 129 Stat. 2242, 3084 (2015).

6 Treas. Reg. § 1.6662-2(c). The penalty rises to 40 percent if any portion of the underpayment is due to a “gross valuation misstatement.” IRC § 6662(h)(1); Treas. Reg. § 1.6662-5(a).

7 IRC § 6664(c)(1).

8 IRC § 6662(c).

9 Treas. Reg. § 1.6662-3(b)(1).

10 Treas. Reg. § 1.6662-3(b)(1)(i).

11 IRC § 6724(d)(1) defines an information return by cross-referencing various other sections of the IRC that require information returns (e.g., IRC § 6724(d)(1)(A)(ii) cross-references IRC § 6042(a)(1) for reporting of dividend payments).

12 Treas. Reg. § 1.6662-3(b)(1)(ii).

13 These factors include the taxpayer’s history of noncompliance; the taxpayer’s failure to maintain adequate books and records; actions taken by the taxpayer to ensure the tax was correct; and whether the taxpayer had an adequate explanation for under-reported income. Internal Revenue Manual (IRM) 4.10.6.2.1, *Negligence* (May 14, 1999). See also IRM 20.1.5.2, *Common Features of Accuracy-Related and Civil Fraud Penalties* (Jan. 24, 2012).

14 IRC § 6662(d)(2)(A)(i)-(ii).

item's tax treatment and the taxpayer had a reasonable basis for the tax treatment.<sup>15</sup> For individuals, the understatement of tax is substantial if it exceeds the greater of \$5,000 or ten percent of the tax that must be shown on the return for the taxable year.<sup>16</sup> For corporations (other than S corporations or personal holding companies), an understatement is substantial if it exceeds the lesser of ten percent of the tax required to be shown on the return for the taxable year (or, if greater, \$10,000), or \$10,000,000.<sup>17</sup>

For example, if the correct amount of tax is \$10,000 and an individual taxpayer reported \$6,000, the substantial underpayment penalty under IRC § 6662(b)(2) would not apply because although the \$4,000 shortfall is more than ten percent of the correct tax, it is less than the fixed \$5,000 threshold. Conversely, if the same individual reported a tax of \$4,000, the substantial understatement penalty would apply because the \$6,000 shortfall is more than \$5,000, which is the greater of the two thresholds.

### Reasonable Cause

The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.<sup>18</sup> A reasonable cause determination takes into account all of the pertinent facts and circumstances.<sup>19</sup> Generally, the most important factor is the extent to which the taxpayer made an effort to determine the proper tax liability.<sup>20</sup>

### Reasonable Basis

An understatement of tax may be reduced by any portion of the understatement attributable to an item for which the tax treatment is adequately disclosed and supported by a reasonable basis.<sup>21</sup> This standard is met if the taxpayer's position reasonably relies on one or more authorities listed in Treas. Reg. § 1.6662-4(d)(3)(iii).<sup>22</sup> Applicable authority could include information such as sections of the IRC; proposed, temporary, or final regulations; revenue rulings and revenue procedures; tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties, court cases, and congressional intent as reflected in committee reports.<sup>23</sup>

15 IRC § 6662(d)(2)(B)(i)-(ii). No reduction is permitted, however, for any item attributable to a tax shelter. See IRC § 6662(d)(2)(C)(i). If a return position is reasonably based on one or more of the authorities set forth in Treas. Reg. § 1.6662-4(d)(3)(iii), the return position will generally satisfy the reasonable basis standard. This may be true even if the return position does not satisfy the substantial authority standard found in Treas. Reg. § 1.6662-4(d)(2). See Treas. Reg. § 1.6662-3(b)(3).

16 IRC § 6662(d)(1)(A)(i)-(ii).

17 IRC § 6662(d)(1)(B)(i)-(ii).

18 IRC § 6664(c)(1).

19 Treas. Reg. § 1.6664-4(b)(1).

20 *Id.*

21 IRC § 6662(d)(2)(B)(ii)(I), (II).

22 Treas. Reg. § 1.6662-3(b)(3).

23 Treas. Reg. § 1.6662-4(d)(3)(iii).

## Penalty Assessment and the Litigation Process

In general, the IRS proposes the accuracy-related penalty as part of its examination process<sup>24</sup> and through its Automated Underreporter (AUR) computer system.<sup>25</sup> Before a taxpayer receives a notice of deficiency, he or she generally has an opportunity to engage the IRS on the merits of the penalty.<sup>26</sup> Once the IRS concludes an accuracy-related penalty is warranted, it must follow deficiency procedures (*i.e.*, IRC §§ 6211-6213).<sup>27</sup> Thus, the IRS must send a notice of deficiency with the proposed adjustments and inform the taxpayer that he or she has 90 days to petition the United States Tax Court to challenge the assessment.<sup>28</sup> Alternatively, taxpayers may seek judicial review through refund litigation.<sup>29</sup> Under certain circumstances, a taxpayer can request an administrative review of IRS collection procedures (and the underlying liability) through a Collection Due Process (CDP) hearing.<sup>30</sup>

## Burden of Proof

In court proceedings, the IRS bears the initial burden of production regarding the accuracy-related penalty.<sup>31</sup> The IRS must first present sufficient evidence to establish that the penalty was warranted.<sup>32</sup> The burden of proof then shifts to the taxpayer to establish any exception to the penalty, such as reasonable cause.<sup>33</sup> Because the reasonable basis standard is a higher standard to meet, it is possible that

24 IRM 4.10.6.2(1), *Recognizing Noncompliance* (May 14, 1999) (“assessment of penalties should be considered throughout the audit”). See also IRM 20.1.5.3(1)-(2), *Examination Penalty Assertion* (Jan. 24, 2012).

25 The Automated Underreporter (AUR) is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payors reported via Form W-2, Form 1099, and other information returns. IRM 4.19.3.1(3)-(8), *Overview of IMF Automated Underreporter* (Sept. 30, 2014). IRC § 6751(b)(1) provides the general rule that IRS employees must have written supervisory approval before assessing any penalty. However, IRC § 6751(b)(2)(B) allows an exception for situations where the IRS can calculate a penalty automatically “through electronic means.” The IRS interprets this exception as allowing it to use its AUR system to propose the substantial understatement and negligence components of the accuracy-related penalty without human review. If a taxpayer responds to an AUR-proposed assessment, the IRS first involves its employees at that point to determine whether the penalty is appropriate. If the taxpayer does not respond timely to the notice, the computers automatically convert the proposed penalty to an assessment without managerial review. IRM 4.19.3.20.1.4, *Accuracy-related Penalties* (Sept. 1, 2012). See also National Taxpayer Advocate 2014 Annual Report to Congress 404-10 (Legislative Recommendation: *Managerial Approval: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence under IRC § 6662(b)(1)*); National Taxpayer Advocate 2007 Annual Report to Congress 259 (“Although automation has allowed the IRS to more efficiently identify and determine when such underreporting occurs, the IRS’s over-reliance on automated systems rather than personal contact has led to insufficient levels of customer service for taxpayers subject to AUR. It has also resulted in audit reconsideration and tax abatement rates that are significantly higher than those of all other IRS examination programs.”).

26 For example, when the IRS proposes to adjust a taxpayer’s liability, including additions to tax such as the accuracy-related penalty, it typically sends a notice (“30-day letter”) of proposed adjustments to the taxpayer. A taxpayer has 30 days to contest the proposed adjustments to the IRS Office of Appeals, during which time he or she may raise issues related to the deficiency, including any reasonable cause defense to a proposed penalty. If the issue is not resolved after the 30-day letter, the IRS sends a statutory notice of deficiency (“90-day letter”) to the taxpayer. See IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest if You Don’t Agree* (Jan. 1999); IRS Pub. 3498, *The Examination Process* (Nov. 2004).

27 IRC § 6665(a)(1).

28 IRC § 6213(a). A taxpayer has 150 days instead of 90 to petition the Tax Court if the notice of deficiency is addressed to a taxpayer outside of the United States.

29 Taxpayers may litigate an accuracy-related penalty by paying the tax liability (including the penalty) in full, filing a timely claim for refund, and then timely instituting a refund suit in the appropriate United States District Court or the Court of Federal Claims. 28 U.S.C. § 1346(a)(1); 28 U.S.C. § 1491; IRC §§ 7422(a); 6532(a)(1); *Flora v. United States*, 362 U.S. 145 (1960) (requiring full payment of tax liabilities as a prerequisite for jurisdiction over refund litigation).

30 IRC §§ 6320 and 6330 provide for due process hearings in which a taxpayer may raise a variety of issues including the underlying liability, provided the taxpayer did not actually receive a statutory notice of deficiency or did not otherwise have an opportunity to dispute such liability. IRC §§ 6320(c), 6330(c)(2)(B).

31 IRC § 7491(c) provides that “the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title.”

32 *Higbee v. Comm’r*, 116 T.C. 438, 446 (2001); IRC § 7491(c).

33 IRC § 7491(a). See also Tax Ct. R. 142(a).



a taxpayer may obtain relief from a penalty assessment by successfully arguing a reasonable cause defense, even if that defense does not satisfy the reasonable basis standard.<sup>34</sup>

## ANALYSIS OF LITIGATED CASES

We identified 122 opinions issued between June 1, 2015 and May 31, 2016, where taxpayers litigated the negligence or disregard of rules or regulations or substantial understatement components of the accuracy-related penalty. The IRS prevailed in full in 86 cases (70 percent), taxpayers prevailed in full in 20 cases (16 percent), and 16 cases (13 percent) resulted in split decisions. Table 1 in Appendix 3 provides a detailed list of these cases.

During the period covered by this report, we noticed a nearly threefold uptick in the number of split decisions in the accuracy-related penalty category. For the period covered by the 2015 Annual Report to Congress, only six out of the 113 total accuracy-related penalty cases (five percent) resulted in split decisions.<sup>35</sup> However, in our review for this year's report, we identified 16 out of the 122 total cases (13 percent) as split decisions.

Taxpayers appeared *pro se* (without representation) in 70 of the 122 cases (57 percent) and convinced the court to dismiss or reduce the penalty in 22 (31 percent) of those cases. Surprisingly, represented taxpayers fared slightly worse, achieving full or partial relief from the penalty in 14 of their 52 cases (27 percent). In contrast, during the same period last year, *pro se* taxpayers did not fare as well, having achieved full or partial penalty relief in 21 percent of cases while represented taxpayers achieved full or partial penalty relief in a similar percentage of cases as this year (27 percent).<sup>36</sup>

In some cases, the court found taxpayers liable for the accuracy-related penalty but failed to clarify whether it was for negligence under IRC § 6662(b)(1) or a substantial understatement of tax under IRC § 6662(b)(2), or both. Regardless of the subsection at issue, the analysis of reasonable cause is generally the same. As such, we have combined our analyses of reasonable cause for the negligence and substantial understatement cases.

### Adequacy of Records and Substantiation of Deductions to Show Reasonable Cause and As Proof of Taxpayer's Good Faith

Taxpayers are required to maintain records sufficient to establish the amount of gross income, deductions, and credits claimed on a return.<sup>37</sup> The failure to “keep adequate books and records or to substantiate items properly” was stated as a primary factor in 55 percent of cases (31 out of 56) where the court found a taxpayer liable for an underpayment penalty due to negligence.<sup>38</sup>

For example, in *Avery v. Commissioner*,<sup>39</sup> married taxpayers operated an information technology company where the wife was the sole shareholder and president of the company and the husband was the executive vice president and sole technician. Mr. Avery worked out of the basement of the couple's home and would make daily automobile trips to the company's clients to provide onsite technical support services

34 Treas. Reg. § 1.6662-3(b)(3).

35 See National Taxpayer Advocate 2015 Annual Report to Congress 450.

36 *Id.*

37 IRC § 6001; Treas. Reg. § 1.6001-1(a).

38 See, e.g., *Boneparte v. Comm'r*, T.C. Memo. 2015-128; *Holden v. Comm'r*, T.C. Memo. 2015-131.

39 T.C. Memo. 2016-50.

as well as to stores to purchase materials. He was not reimbursed by the company for his automobile expenses.

The couple engaged a tax return preparer, who was referred to them by acquaintances, to prepare their 2011 Form 1040, *U.S. Individual Income Tax Return*. Their return reflected an automobile expense of \$39,991, an amount that would indicate that Mr. Avery drove approximately 75,000 miles for business according to the IRS's standard mileage rate for 2011. The IRS selected the couple's return for examination and the agent conducting the exam requested substantiation of the claimed automobile expenses. Mr. Avery claimed he maintained a mileage log where he would record the dates, number, and mileage of the trips he made in the automobile but stated that he lost this log. The IRS issued a notice of deficiency, which disallowed the claimed automobile expenses and asserted an accuracy-related penalty for negligence.<sup>40</sup>

The couple challenged the notice of deficiency in the Tax Court. At trial, Mr. Avery was the taxpayers' only witness but he did not produce his mileage log. Instead, he provided three items:

1. A list of names of the company's clients and related invoices;
2. Receipts for the servicing and repair of Mr. Avery's automobile that he used for business travel; and
3. A list reflecting his estimated business mileage from January through April 2011.

The court noted that IRC § 162 allows a deduction from income for all ordinary and necessary expenses for carrying on a trade or business and that, under IRC § 6001, taxpayers are generally required to keep records substantiating amounts reported on a tax return.<sup>41</sup> The court also pointed out that automobile expense deductions are subject to the strict substantiation requirements of IRC § 274(d), which provides, among other things, that no deduction may be allowed with respect to any property listed in § 280F(d)(4) unless the taxpayer establishes:

- (A) The amount of the expense or other item;
- (B) The time and place of the use of the property;
- (C) The business purpose of the expense; and
- (D) The business relationship to the taxpayer of the person using the property.

The court further noted that deductions arising from property subject to the strict substantiation requirements set forth in § 274(d) are disallowed in full unless that taxpayer meets each element of these requirements and also discussed the related regulations.<sup>42</sup>

Turning to the evidence introduced by Mr. Avery, the court first highlighted the fact that he failed to produce his mileage log at trial. The court then found that each of the three pieces of evidence that he provided failed to meet the § 274(d) substantiation requirements. Mr. Avery had failed to explain how he calculated his mileage driven, receipts he provided did not explain business use of the automobile, and he

40 Because the taxpayers' automobile expenses were incorrectly claimed on a Schedule C, *Profit or Loss From Business (Sole Proprietor)*, the IRS mistakenly believed that Mr. Avery operated a sole proprietorship and was therefore also liable for self-employment tax. The IRS later conceded that Mr. Avery did not operate a sole proprietorship and was not liable for the self-employment tax.

41 For a more detailed discussion of whether or not a taxpayer is considered to be in a trade or business and entitled to certain deductions, see Most Litigated Issue: *Trade or Business Expenses Under IRC § 162 and Related Sections*, *infra*.

42 See Treas. Reg. § 1.274-5T(c).

acknowledged that his recollection of trips made to client sites was not reliable and that he did not keep records regarding daily visits to clients who had ongoing maintenance contracts with the company.

The court stated that it had no doubt that Mr. Avery drove to the worksites of the company's clients. However, because he did not meet the strict substantiation requirements of § 274(d), the court disallowed the taxpayers' claimed automobile expense deductions. The court also imposed the § 6662(b)(1) accuracy-related penalty for negligence, as it found the taxpayers failed to keep adequate books and records. Finally, the court dismissed the taxpayers' defense to the penalty by claiming reasonable cause and good faith reliance on a tax professional, an area that will be discussed in more detail below.

Inadequate record keeping was also an important factor in many determinations of whether the reasonable cause and good faith exception applied to a taxpayer's conduct. Some courts examined the issues of negligent record keeping and reasonable cause concurrently.

For example, in *Boneparte v. Commissioner*,<sup>43</sup> the taxpayer petitioned the Tax Court to challenge a notice of deficiency stemming from claimed deductions relating to gambling losses, medical transportation expenses, nonbusiness bad debts, an IRC § 72(t) ten percent additional tax on an early retirement plan distribution, and an accuracy-related penalty under IRC § 6662(b)(1). The court found, among other things, that the taxpayer did not maintain appropriate records of his gambling activity, medical transportation expenses, and nonbusiness bad debts. It therefore did not allow any of these deductions. The court also imposed an IRC § 6662(b)(1) accuracy-related penalty for negligence, noting the taxpayer's failure to keep accurate records for his claimed deductions and that he did not show reasonable cause for this failure. Thus, the court rejected reasonable cause based on the same evidence that established negligence.

### Reliance on the Advice of a Tax Professional As Reasonable Cause

Another commonly litigated question was whether reliance on a tax professional established reasonable cause. The taxpayer's education, sophistication, and business experience are relevant in determining whether his or her reliance on tax advice was reasonable.<sup>44</sup> To prevail, a taxpayer must establish that:

1. The advisor was a competent professional who had sufficient expertise to justify reliance;
2. The taxpayer provided necessary and accurate information to the advisor; and
3. The taxpayer actually relied in good faith on the adviser's judgment.<sup>45</sup>

Taxpayers argued their good faith reliance on a competent tax professional in several cases this year, including *Espaillet v. Commissioner*.<sup>46</sup> In *Espaillet*, a married couple filed joint Federal income tax returns for 2008 and 2009 claiming losses that stemmed from a scrap metal business operated by Mr. Espaillet's brother. The couple primarily ran a successful landscaping business but Mr. Espaillet and other family members also spent a significant amount of time assisting his brother with the scrap metal business, which was not successful. Under the advice of their certified public accountant (CPA), the Espaillets claimed the losses as "other expenses" deductions on their Schedule C. The IRS later audited the couple's tax returns for these years and disallowed the "other expenses" deductions. Due to the disallowed deductions, the IRS also assessed an accuracy-related penalty under IRC § 6662(b)(1) or, in the alternative, § 6662(b)(2).

43 T.C. Memo. 2015-128.

44 Treas. Reg. § 1.6664-4(c)(1). See also IRM 20.1.5.6.1(6), *Reasonable Cause* (Jan. 24, 2012).

45 *Neonatology Associates, P.A. v. Comm'r*, 115 T.C. 43, 99 (2000) (citations omitted), *aff'd*, 299 F.3d 221 (3rd Cir. 2002).

46 T.C. Memo. 2015-202. See also *Lamas-Richie v. Comm'r*, T.C. Memo. 2016-63; *Vandenbosch v. Comm'r*, T.C. Memo. 2016-29.

Although it found various reasons why the taxpayers were not entitled to their claimed loss deductions for 2008 and 2009, the court ruled that the couple was not liable for accuracy-related penalties because they acted with reasonable cause and relied in good faith on their CPA. In examining this defense, the court noted that the couple ran a successful landscaping business and that Mr. Espaillet was familiar with running a business and keeping appropriate records but was unfamiliar with the tax code. It also highlighted the fact that the taxpayers had sought the help of a CPA, who had assisted them for over a decade, to prepare their returns for the years in issue. The CPA had the taxpayers each fill out a questionnaire each year before preparing their returns, which they thoroughly completed. The CPA also testified that the taxpayers provided all requisite information and that he discussed the taxpayers' situation with them and thought the Schedule C reporting of the scrap metal loss deduction was appropriate. Finally, the court mentioned that the CPA had over 30 years of experience and that because the taxpayers had always used a Schedule C for their landscaping business, they acted in good faith in relying on their CPA's advice to report their scrap metal financial dealings on a Schedule C. Because they acted with reasonable cause and in good faith reliance on their CPA, they were not liable for accuracy-related penalties under IRC § 6662(b)(1) or (b)(2).<sup>47</sup>

In contrast, married taxpayers in *Ogden v. Commissioner*<sup>48</sup> were held liable for an accuracy-related penalty because the couple had neither reasonably, nor in good faith relied on their CPA's advice in preparation of their Federal income tax return.

In 2010, Mr. and Mrs. Ogden filed a joint Federal income tax return, with most of the income coming from Mr. Ogden's law practice. The IRS audited the Ogdens' return and determined that they had claimed a contract labor expense of approximately \$500,000 twice and had failed to report \$450,000 of gross receipts. Based on this, the IRS asserted a deficiency of \$255,040 and an accuracy-related penalty of \$51,008. The taxpayers accepted the deficiency but contested the penalty,<sup>49</sup> arguing that they reasonably relied on advice from their CPA to prepare their return and that the underpayment was the result of an isolated computational error.<sup>50</sup>

The court found that the taxpayers did not reasonably and in good faith rely on the advice of the CPA who prepared their 2010 return. It noted that the taxpayers did not call as a witness the CPA who prepared their return nor did they present any evidence that he provided advice that they could rely on. The court also pointed out that had the taxpayers conducted a reasonable inspection of the return, they would have discovered the duplicated expense deduction and the unreported income. The court believed that Mr. Ogden had sufficient knowledge of the workings of his law firm to detect these errors and that more diligence was necessary to assess the taxpayers' proper tax liability. Therefore, the taxpayers could not claim reasonable cause and good faith reliance on their CPA and were liable for the accuracy-related penalty.

47 Interestingly, the court did not cite the *Neonatology* case in discussing the requirements for good faith reliance on a tax professional. Rather, it cited *Estate of Goldman v. Commissioner*, 112 T.C. 317, 324 (1999) (citing *Metra Chem Corp. v. Commissioner*, 88 T.C. 654, 662 (1987)), *aff'd without published opinion sub nom., Schutter v. Commissioner*, 242 F.3d 390 (10th Cir. 2000). *Estate of Goldman* has a slightly different formulation of the three requirements for good faith reliance on a tax professional but they are substantially the same as the *Neonatology* ones.

48 T.C. Memo. 2015-241.

49 The taxpayers stipulated that they were liable for an accuracy-related penalty for the unreported income so the court only examined whether they were liable for the penalty as it related to the duplicated contract labor expenses.

50 This is a rare case in which only the accuracy-related penalty was at issue before the court. In most cases, taxpayers challenged both the deficiency and the accuracy-related penalty.

## Individual Retirement Accounts

As in previous years, we identified several accuracy-related penalty cases under IRC § 6662(b)(1) and (b)(2) that involved individual retirement accounts (IRA) issues.<sup>51</sup>

For example, in *Ellis v. Commissioner*,<sup>52</sup> married taxpayers appealed a Tax Court decision holding that the taxpayers were liable for a deficiency, a ten percent additional tax on an early distribution from a qualified retirement plan, and an IRC § 6662(b)(2) accuracy-related penalty due to Mr. Ellis's engaging in a prohibited transaction with his IRA. In 2005, Mr. Ellis formed a limited liability company (LLC) to engage in the business of used automobile sales. He was also designated to act as the general manager of the LLC and received a salary. In order to fund this venture, Mr. Ellis transferred funds from a 401(k) he had established with a previous employer into a newly formed IRA. He then purchased shares of the LLC with funds from the IRA. Mr. Ellis reported the distributions on his 2005 return but did not report them as taxable.

The IRS examined the Ellis's tax returns for 2005 and 2006 and determined that Mr. Ellis had engaged in prohibited transactions under IRC § 4975(c) by directing his IRA to acquire a membership interest in the LLC with the expectation that the company would employ him and receiving wages from the LLC.<sup>53</sup> As a result, the IRS asserted that Mr. Ellis's IRA lost its status as an individual retirement account and, under IRC § 408(e)(2), its entire fair market value was to be treated as taxable income. The IRS also asserted an IRC § 6662 accuracy-related penalty.

The Tax Court agreed with the IRS that Mr. Ellis engaged in a prohibited transaction by causing the LLC to pay him wages in 2005, which violated the rules of IRC § 4975. The Tax Court also sustained the IRC § 6662 accuracy-related penalty, as it found that the taxpayers had a substantial understatement of income under IRC § 6662(b)(2) and had not demonstrated reasonable cause. On appeal, the Eighth Circuit affirmed the Tax Court's decision, agreeing that Mr. Ellis had indeed engaged in a prohibited transaction with the LLC and was therefore liable for the deficiency and accuracy-related penalty.

## CONCLUSION

Over this last reporting period, the issue of accuracy-related penalties under IRC § 6662(b)(1) and (b)(2) was decided by the courts in 122 cases. Litigation on the issue climbed by nine cases (from 113) over the last reporting period.<sup>54</sup> For the current reporting period, the IRS prevailed in full in 70 percent of these cases, which is the lowest percentage reported since 2012.<sup>55</sup>

Also notable is the fact that *pro se* taxpayers fared slightly better than represented ones and an increase in the number of split decisions. In addition, as the National Taxpayer Advocate discussed in a research study in her 2013 Annual Report to Congress, there are circumstances where the IRS's imposition of accuracy-related penalties, and where penalized taxpayers were subject to a default assessment, appealed their assessment, or whose penalty was subsequently abated, may lead to increased future

51 See, e.g., *Dunn v. Comm'r*, T.C. Memo. 2015-208; *Niemann v. Comm'r*, T.C. Memo. 2016-11.

52 *Ellis v. Comm'r*, 787 F.3d 1213 (8th Cir. 2015), *aff'g* T.C. Memo. 2013-245.

53 The IRS asserted deficiencies and penalties in the alternative for either 2005 or 2006.

54 See National Taxpayer Advocate 2015 Annual Report to Congress 450.

55 See National Taxpayer Advocate 2015 Annual Report to Congress 450 (77 percent); National Taxpayer Advocate 2014 Annual Report to Congress 446 (78 percent); National Taxpayer Advocate 2013 Annual Report to Congress 341 (78 percent); National Taxpayer Advocate 2012 Annual Report to Congress 589 (66 percent).

noncompliance.<sup>56</sup> As noted in the study, this may be due to taxpayer perception of accuracy-related penalties in these circumstances as unfair, thereby undermining the purpose of these penalties, which are supposed to promote voluntary compliance.<sup>57</sup>

Courts most often cited inadequate maintenance of records when imposing an accuracy-related penalty. When accepting a defense for reasonable cause and good faith, courts were most likely to cite reliance on a tax professional and manifestations of taxpayer efforts to comply with the tax code.

It is also important to note that Congress enacted law in 2015 reversing the Tax Court's decision in *Rand v. Commissioner*, in which the Tax Court had held that refundable credits cannot reduce the amount shown as tax by the taxpayer on a return below zero.<sup>58</sup> Congress amended IRC § 6664(a) to be consistent with the rule of IRC § 6211(b)(4), which allows the IRS to calculate negative tax in computing the amount of underpayment for accuracy-related penalty purposes.<sup>59</sup> Thus, for returns filed after December 18, 2015, or for returns filed on or before that date for which the period of limitations on assessment under IRC § 6501 has not expired, a taxpayer can be subject to an underpayment penalty in IRC § 6662 based on a refundable credit which reduces tax below zero.

56 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 1-14 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

57 *Id.*

58 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 209, 129 Stat. 2242, 3084 (2015). See also *Rand v. Comm'r*, 141 T.C. 376 (2013).

59 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 209, 129 Stat. 2242, 3084 (2015).



MLI  
#2**Appeals From Collection Due Process (CDP) Hearings Under IRC §§ 6320 and 6330****SUMMARY**

The IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> created Collection Due Process (CDP) hearings to provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.<sup>2</sup>

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court.<sup>3</sup> Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.<sup>4</sup>

Since 2001, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 99 opinions on CDP cases during the review period of June 1, 2015 through May 31, 2016, which is an increase of 25 percent since last year's report.<sup>5</sup> Taxpayers prevailed in full in ten of these cases (ten percent) and, in part, in six others (six percent). The 16 percent success rate for the taxpayers is one of the highest success rates since the inception of CDP hearings. Of the 16 opinions where taxpayers prevailed in whole or in part, eight taxpayers appeared *pro se*<sup>6</sup> and eight were represented.

The cases discussed below demonstrate that CDP hearings serve an important role in providing taxpayers with a venue to raise legitimate issues before the IRS deprives the taxpayer of property. Many of these decisions shed light on substantive and procedural issues.

CDP hearings are particularly valuable because they provide taxpayers with an enforceable remedy with respect to several rights articulated in the Taxpayer Bill of Rights (TBOR), which was adopted by the IRS in 2014 and was subsequently incorporated in the Internal Revenue Code (IRC) in response to National Taxpayer Advocate recommendations.<sup>7</sup> In particular, by providing an opportunity for a taxpayer to

1 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 Internal Revenue Code (IRC) §§ 6320(c) (lien) and 6330(c) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test.

3 IRC § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

4 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review and upon a showing of "good cause," if the underlying tax liability is not at issue.

5 For a list of all cases reviewed, see table 2 in Appendix 3, *infra*.

6 *Pro se* means "[f]or oneself; on one's own behalf; without a lawyer." *Pro Se*, BLACK'S LAW DICTIONARY (10th ed. 2014).

7 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

challenge the underlying liability and raise alternatives to the collection action, the CDP hearing enables the taxpayer's *right to challenge the IRS's position and be heard*. If the taxpayer does not agree with the Appeals' determination, he or she may file a petition in Tax Court, which furthers the taxpayer's *right to appeal an IRS decision in an independent forum*. Lastly, since the Appeals Officer (AO) must consider whether the IRS's proposed collection action balances the overall need for efficient collection of taxes with the legitimate concern that the IRS's collection actions are no more intrusive than necessary, the CDP hearing protects a taxpayer's *right to privacy* while also ensuring the taxpayer's *right to a fair and just tax system*.

## TAXPAYER RIGHTS IMPACTED<sup>8</sup>

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

## PRESENT LAW

Current law provides taxpayers an opportunity for independent review of an NFTL filed by the IRS or of a proposed levy action.<sup>9</sup> As discussed above, the purpose of CDP rights is to give taxpayers adequate notice of IRS collection activity and a meaningful hearing before the IRS deprives the taxpayer of property.<sup>10</sup> The hearing allows taxpayers to raise issues related to collection of the liability, including:

- The appropriateness of collection actions;<sup>11</sup>
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;<sup>12</sup>
- Appropriate spousal defenses;<sup>13</sup>
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a statutory notice of deficiency (SNOD) or have another opportunity to dispute the liability;<sup>14</sup> and
- Any other relevant issue relating to the unpaid tax, the NFTL, or the proposed levy.<sup>15</sup>

<sup>8</sup> See TBOR, [www.irs.gov/advocate/taxpayer-rights](http://www.irs.gov/advocate/taxpayer-rights).

<sup>9</sup> IRC §§ 6320 and 6330. See RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

<sup>10</sup> Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. See *U.S. v. Nat'l Bank of Commerce*, 472 U.S. 713, 726-31 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

<sup>11</sup> IRC § 6330(c)(2)(A)(ii).

<sup>12</sup> IRC § 6330(c)(2)(A)(iii).

<sup>13</sup> IRC § 6330(c)(2)(A)(i).

<sup>14</sup> IRC § 6330(c)(2)(B).

<sup>15</sup> IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

A taxpayer cannot raise an issue considered at a prior administrative or judicial hearing if the taxpayer participated meaningfully in that hearing or proceeding.<sup>16</sup>

### Procedural Collection Due Process (CDP) Requirements

The IRS must provide a CDP notice to the taxpayer after filing the first NFTL and generally before its first intended levy for the particular tax and tax period.<sup>17</sup> The IRS must provide the notice not more than five business days after the day of filing the NFTL, or at least 30 days before the day of the proposed levy.<sup>18</sup>

If the IRS files a lien, the CDP lien notice must inform the taxpayer of the right to request a CDP hearing within a 30-day period, which begins on the day after the end of the five-business day period after the filing of the NFTL.<sup>19</sup> In the case of a proposed levy, the CDP levy notice must inform the taxpayer of the right to request a hearing within the 30-day period beginning on the day after the date of the CDP notice.<sup>20</sup>

### Requesting a Collection Due Process (CDP) Hearing

Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing within the applicable period.<sup>21</sup> The Code and regulations require taxpayers to provide their reasons for requesting a hearing.<sup>22</sup> Failure to provide the basis may result in denial of a face-to-face hearing.<sup>23</sup> Taxpayers who fail to timely request a CDP hearing will be afforded an “equivalent hearing,” which is similar to a CDP hearing but lacks judicial review.<sup>24</sup> Taxpayers must request an equivalent hearing within the one-year period beginning the day after the five-business day period following the

<sup>16</sup> IRC § 6330(c)(4).

<sup>17</sup> IRC § 6330(f) permits the IRS to levy without first giving a taxpayer a CDP notice in the following situations: the collection of tax is in jeopardy, a levy was served on a state to collect a state tax refund, the levy is a disqualified employment tax levy, or the levy was served on a federal contractor. A disqualified employment tax levy is any levy to collect employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h)(1). A federal contractor levy is any levy if the person whose property is subject to the levy (or any predecessor thereof) is a federal contractor. IRC § 6330(h)(2). Under IRC § 6330(f), the IRS must still provide the opportunity for a CDP hearing “within a reasonable period of time after the levy.”

<sup>18</sup> IRC §§ 6320(a)(2) or 6330(a)(2). The CDP notice can be provided to the taxpayer in person, left at the taxpayer’s dwelling or usual place of business, or sent by certified or registered mail (return receipt requested, for the CDP levy notice) to the taxpayer’s last known address.

<sup>19</sup> IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

<sup>20</sup> *Id.*

<sup>21</sup> IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2), Question and Answer (Q&A) (C)(1)(ii) and 301.6330-1(c)(2), Q&A (C)(1)(ii).

<sup>22</sup> Treas. Reg. §§ 301.6320-1(c)(2), Q&A (C)(1)(ii) and 301.6330-1(c)(2), Q&A (C)(1)(ii).

<sup>23</sup> IRC §§ 6320(b)(1) and 6330(b)(1); Treas. Reg. §§ 301.6320-1(c)(2), Q&A (C)(1); 301.6330-1(c)(2), Q&A (C)(1); 301.6320-1(d)(2), Q&A (D)(8); and 301.6330-1(d)(2), Q&A (D)(8). The regulations require the IRS to provide the taxpayer an opportunity to “cure” any defect in a timely filed hearing request, including providing a reason for the hearing. Form 12153 includes space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider, as well as examples of common reasons for requesting a hearing. See IRS Form 12153, *Requests for Collection Due Process or Equivalent Hearing* (Dec. 2013).

<sup>24</sup> Treas. Reg. §§ 301.6320-1(i)(2), Q&A (I6) and 301.6330-1(i)(2), Q&A (I6); *Business Integration Servs., Inc. v. Comm’r*, T.C. Memo. 2012-342 at 6-7; *Moorhouse v. Comm’r*, 116 T.C. 263 (2001). A taxpayer can request an Equivalent Hearing by checking a box on Form 12153, *Requests for Collection Due Process or Equivalent Hearing*, by making a written request, or by confirming that he or she wants the untimely CDP hearing request to be treated as an Equivalent Hearing when notified by Collection of an untimely CDP hearing request. Internal Revenue Manual (IRM) 5.19.8.4.3, *Equivalent Hearing (EH) Requests and Timeliness of EH Requests* (Nov. 1, 2007).

filing of the NFTL, or in levy cases, within the one-year period beginning the day after the date of the CDP notice.<sup>25</sup>

### Conduct of a Collection Due Process (CDP) Hearing

The IRS generally will suspend the levy action throughout a CDP hearing involving a notice of intent to levy. However, the requirement to suspend a levy action is inapplicable in certain circumstances where the IRS is not required to provide a CDP hearing prior to the levy and is only required to provide the CDP hearing within a reasonable time after the levy.<sup>26</sup> These circumstances occur when the IRS determines that:

- The collection of tax is in jeopardy;
- The collection resulted from a levy on a state tax refund;
- The IRS has served a disqualified employment tax levy; or
- The IRS has served a federal contractor levy.<sup>27</sup>

The IRS also suspends levy action throughout any judicial review of Appeals' determination, unless the IRS obtains an order from the court permitting levy on the grounds that the underlying tax liability is not at issue, and the IRS can demonstrate good cause to resume collection activity.<sup>28</sup>

CDP hearings are informal. When a taxpayer requests a hearing with respect to both a lien and a proposed levy, Appeals will attempt to conduct one hearing.<sup>29</sup> Courts have determined that a CDP hearing need not be face-to-face but can take place by telephone or correspondence,<sup>30</sup> and Appeals will typically conduct the hearing by telephone unless the taxpayer requests a face-to-face conference.<sup>31</sup> The CDP regulations state that taxpayers who provide non-frivolous reasons for opposing the IRS collection

25 Treas. Reg. §§ 301.6320-1(i)(2), Q&A (I7) and 301.6330-1(i)(2), Q&A (I7).

26 See, e.g., *Dorn v. Comm'r*, 119 T.C. 356 (2002); *Zapara v. Comm'r*, 124 T.C. 223 (2005); *Bibby v. Comm'r*, T.C. Memo. 2013-281.

27 IRC § 6330(e)(1) provides the general rule for suspending collection activity. IRC § 6330(f) provides that if collection of the tax is deemed in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS served a disqualified employment tax levy or a federal contractor levy, IRC § 6330 does not apply, except to provide the opportunity for a CDP hearing within a reasonable time after the levy. See *Clark v. Comm'r*, 125 T.C. 108, 110 (2005) (citing *Dorn v. Comm'r*, 119 T.C. 356 (2002)).

28 IRC §§ 6330(e)(1) and (e)(2).

29 IRC § 6320(b)(4).

30 *Katz v. Comm'r*, 115 T.C. 329, 337-38 (2000) (finding that telephone conversations between the taxpayer and the Appeals Officer (AO) constituted a hearing as provided in IRC § 6320(b)). Treas. Reg. §§ 301.6320-1(d)(2), Q&A (D)(6), Q&A (D)(8) and 301.6330-1(d)(2), Q&A (D)(6), Q&A (D)(8).

31 See, e.g., *Appeals Letter 4141* (rev. June 2013) (acknowledging the taxpayer's request for a CDP hearing and providing information on the availability of face-to-face conference). The National Taxpayer Advocate has repeatedly raised concerns regarding the inadequacy of Appeals' communication to taxpayers on how to request a face-to-face hearing and where this information is included in the letter. See National Taxpayer Advocate 2005 Annual Report to Congress 136 (Most Serious Problem: *Appeals Campus Centralization*); National Taxpayer Advocate 2009 Annual Report to Congress 70 (Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Customer Satisfaction or Confidence in Appeals*); National Taxpayer Advocate 2010 Annual Report to Congress 128 (Most Serious Problem: *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered*). For information regarding the availability of Virtual Service Delivery (VSD) teleconferencing, which provides a virtual face-to-face meeting in remote locations, see National Taxpayer Advocate 2012 Annual Report to Congress 462 (Status Update: *The IRS Has Made Significant Progress in Delivering Face-to-Face Service and Should Expand its Initiatives to Meet Taxpayer Needs and Improve Compliance*). See also Director, Policy, Quality and Case Support, *Implementation of Virtual Service Delivery (VSD)*, Memorandum AP-08-0714-0007 (July 24, 2014). Additionally, the IRS has recently adopted a new IRM, IRM 8.6.1.4.1, *Conference Practice* (Oct. 1, 2016), and the issue of how this new policy will be applied in the case of CDP appeals remains an open and troubling question. For a more detailed discussion of the Appeals policy of generally limiting in-person conferences, see Most Serious Problem: *Appeals: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values, supra*.

action will generally be offered but not guaranteed face-to-face conferences.<sup>32</sup> Taxpayers making frivolous arguments are not entitled to face-to-face conferences.<sup>33</sup> A taxpayer will not be granted a face-to-face conference concerning a collection alternative, such as an IA or OIC, unless other taxpayers would be eligible for the alternative under similar circumstances.<sup>34</sup> For example, the IRS will not grant a face-to-face conference to a taxpayer who proposes an OIC as the only issue to be addressed but failed to file all required returns and is therefore ineligible for an offer. Appeals may, however, at its discretion, grant a face-to-face conference to explain the eligibility requirements for a collection alternative.<sup>35</sup>

The CDP hearing is to be held by an impartial officer from Appeals, who is barred from engaging in *ex parte*<sup>36</sup> communication with IRS employees about the substance of the case and who has had “no prior involvement.”<sup>37</sup> In addition to addressing the issues raised by the taxpayer, the AO must verify that the IRS has met the requirements of all applicable laws and administrative procedures.<sup>38</sup> An integral component of the CDP analysis is the balancing test, which requires the IRS AO to weigh the issues raised by the taxpayer and determine whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be “no more intrusive than necessary.”<sup>39</sup> The balancing test is central to a CDP hearing because it instills a genuine notion of fairness into the process from the perspective of the taxpayer.<sup>40</sup>

Special rules apply to the IRS’s handling of hearing requests that raise frivolous issues. IRC § 6330(g) provides that the IRS may disregard any portion of a hearing request based on a position the IRS has identified as frivolous or that reflects a desire to delay or impede the administration of tax laws.<sup>41</sup> Similarly, IRC § 6330(c)(4) provides that a taxpayer cannot raise an issue if it is based on a position identified as frivolous or reflects a desire to delay or impede tax administration.

32 Treas. Reg. §§ 301.6320-1(d)(2), Q&A (D)(7) and 301.6330-1(d)(2), Q&A (D)(7).

33 Treas. Reg. §§ 301.6320-1(d)(2), Q&A (D)(8) and 301.6330-1(d)(2), Q&A (D)(8).

34 *Id.*

35 *Id.*

36 *Ex parte* means “done or made at the instance and for the benefit of one party only, and without notice to, or argument by, anyone having an adverse interest.” *Ex parte*, BLACK’S LAW DICTIONARY (10th ed. 2014).

37 IRC §§ 6320(b)(1), 6320(b)(3), 6330(b)(1), and 6330(b)(3). See also Rev. Proc. 2012-18, 2012-1 C.B. 455. See, e.g., *Industrial Investors v. Comm’r*, T.C. Memo. 2007-93; *Moore v. Comm’r*, T.C. Memo. 2006-171, *action on dec.*, 2007-2 (Feb. 27, 2007); *Cox v. Comm’r*, 514 F.3d 1119, 1124-28 (10th Cir. 2008), *action on dec.*, 2009-22 (June 1, 2009).

38 IRC § 6330(c)(1); *Hoyle v. Comm’r*, 131 T.C. 197 (2008).

39 IRC § 6330(c)(3)(C); IRM 8.22.4.2.2, *Summary of CDP Process* (Sept. 25, 2014). See also H.R. REP. NO. 105-599, at 263 (1998). For simplicity, we use the term “proposed collection action” referring to both the actions taken and proposed. IRC § 6330 requires the IRS to notify the taxpayer of the right to request a CDP hearing not less than 30 days before issuing the first levy to collect a tax. Pursuant to IRC § 6320, the taxpayer is notified of the right to request a CDP hearing within five business days after the first NFTL for a tax period that is filed. Thus, Treasury Regulations under IRC § 6320 require a Hearing Officer to consider “[w]hether the continued existence of the filed [NFTL] represents a balance between the need for the efficient collection of taxes and the legitimate concern of the taxpayer that any collection action be no more intrusive than necessary.” See Treas. Reg. § 301.6320-1(e)(3), Q&A (E)(1)(vi). Similarly, a levy action can be taken before a hearing in the following situations: collection of the tax was in jeopardy; levy on a state to collect a federal tax liability from a state tax refund; disqualified employment tax levies; or a federal contractor levy under the Federal Payment Levy Program (FPLP). See IRC § 6330(f); IRM 8.22.4.2.2, *Summary of CDP Process* (Sept. 25, 2014).

40 See National Taxpayer Advocate 2014 Annual Report to Congress 185-96 (Most Serious Problem: *Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*). See also Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, 63 Tax Law. 227 (2010).

41 IRC § 6330(g). IRC § 6330(g) is effective for submissions made and issues raised after the date on which the IRS first prescribed a list of frivolous positions. Notice 2007-30, 2007-1 C.B. 833, which was published on or about April 2, 2007, provided the first published list of frivolous positions. Notice 2010-33, 2010-17 C.B. 609, contains the current list.



IRC § 6702(b) allows the IRS to impose a penalty for a specified frivolous submission, including a frivolous CDP hearing request.<sup>42</sup> A request is subject to a penalty if any part of it “(i) is based on a position which the Secretary has identified as frivolous ... or (ii) reflects a desire to delay or impede the administration of Federal tax laws.”<sup>43</sup> A taxpayer can timely petition the Tax Court to review an Appeals decision if Appeals determined that a request for an administrative hearing was based entirely on a frivolous position under IRC § 6702(b)(2)(A) and issued a notice stating that Appeals will disregard the request.<sup>44</sup> An Appeals letter disregarding a CDP hearing request is a determination that confers jurisdiction under IRC § 6330(d)(1), because it authorizes the IRS to proceed with the disputed collection action.<sup>45</sup> The IRS Office of Chief Counsel disagreed with the Tax Court precedent in *Thornberry* and is maintaining the position that the Tax Court lacks jurisdiction to review a petition resulting from the denial of a frivolous hearing request under section 6330(g).<sup>46</sup>

Recently, in *Ryskamp v. Commissioner*, the D.C. Circuit upheld the Tax Court’s precedent in *Thornberry* that the IRS’s disregard of a taxpayer’s CDP hearing request as frivolous under IRC § 6330(g) is subject to judicial review, and affirmed the Tax Court’s holding that the IRS abused its discretion in rejecting a taxpayer’s request for a hearing by sending boilerplate rejection letters that do not articulate the grounds of the frivolousness determination.<sup>47</sup> While the IRS Office of Chief Counsel disagrees with *Ryskamp* on both issues, Counsel has modified its litigating guidelines as follows:

- Counsel will no longer file a motion to dismiss to contest the Tax Court’s threshold jurisdiction to evaluate whether a CDP hearing was properly denied under IRC § 6330(g);
- Counsel will request a remand to Appeals where a hearing was improperly denied;
- Where a hearing was properly denied, instead of filing a motion to remand so Appeals can more fully explain the reasons for rejecting the taxpayer’s arguments as frivolous, Counsel will file an appropriate motion with the court to resolve the case through a dismissal or summary judgment; and
- Counsel will also consider filing a motion to permit levy so that the Service can immediately levy after the Tax Court’s order.<sup>48</sup>

42 The frivolous submission penalty applies to the following submissions: CDP hearing requests under IRC §§ 6320 and 6330, OIC under IRC § 7122, IAs under IRC § 6159, and applications for a TAO under IRC § 7811.

43 IRC § 6702(b)(2)(A). Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous hearing request. The taxpayer has 30 days to withdraw the submission to avoid the penalty. IRC § 6702(b)(3).

44 See *Thornberry v. Comm’r*, 136 T.C. 356, 367 (2011). The D.C. Appeals Court recently upheld *Thornberry* in *Ryskamp v. Comm’r*, 116 A.F.T.R.2d (RIA) 5614 (D.C. Cir. Aug. 14, 2015) cert. denied, 136 U.S. 834 (2016). See also National Taxpayer Advocate 2015 Annual Report to Congress 489 (Most Litigated Issue: *Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330*).

45 *Thornberry v. Comm’r*, 136 T.C. 356, 364 (2011).

46 See IRS Chief Counsel Notice CC-2012-003, *Disregarding Frivolous CDP Hearing Requests Under Section 6330(g)* (Dec. 2, 2011).

47 *Ryskamp v. Comm’r*, 797 F.3d 1142 (D.C. Cir. 2015), cert. denied, 136 U.S. 834 (2016). For a further discussion of *Ryskamp*, see Issues Litigated, *infra*.

48 IRS Chief Counsel Notice CC-2016-008, *Disregarding Frivolous CDP Hearing Requests Under Section 6330(g)* (Apr. 4, 2016). In her 2014 Annual Report to Congress, the National Taxpayer Advocate expressed concerns about the Office of Appeals not giving proper attention to the CDP balancing test, especially to legitimate concerns of taxpayers regarding the intrusiveness of the proposed collection action, and often using *pro forma* statements that the balancing test has been conducted. See National Taxpayer Advocate 2014 Annual Report to Congress 185-96 (Most Serious Problem: *Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*).



### Judicial Review of a Collection Due Process (CDP) Hearing

Within 30 days of Appeals' determination, the taxpayer may petition the Tax Court for judicial review.<sup>49</sup> The court will only consider issues, including challenges to the underlying liability, that were properly raised during the CDP hearing.<sup>50</sup> An issue is not properly raised if the taxpayer fails to request Appeals' consideration of the issue or requests consideration but fails to present any evidence regarding that issue after being given a reasonable opportunity.<sup>51</sup> The Tax Court, however, may remand a case back to Appeals for more fact finding when the taxpayer's factual circumstances have materially changed between the hearing and the trial.<sup>52</sup> When the case is remanded, the Tax Court retains jurisdiction.<sup>53</sup> The resulting hearing on remand provides the parties with an opportunity to complete the initial hearing while preserving the taxpayer's right to receive judicial review of the ultimate administrative determination.<sup>54</sup>

Where the validity of the underlying tax liability is properly at issue in the hearing, the court will review the amount of the tax liability on a *de novo*<sup>55</sup> basis.<sup>56</sup> Where the Tax Court is reviewing the appropriateness of the collection action or subsidiary factual and legal findings, the court will review these determinations under an abuse of discretion standard.<sup>57</sup>

### Appellate Venue From Decisions of the Tax Court

Generally, the correct venue for appeals from the Tax Court is the D.C. Circuit unless one of the rules specified in IRC § 7482(b)(1) or exceptions specified in IRC §§ 7482(b)(2) or (b)(3) applies. For instance, IRC § 7482(b)(1)(A) provides that in cases where a petitioner other than a corporation seeks redetermination of a tax liability, venue for review by the United States Court of Appeals lies with the Court of Appeals for the circuit based upon the taxpayer's legal residence.<sup>58</sup> Pursuant to IRC § 7482(b)(2), the taxpayer and the IRS may stipulate the venue for an appeal in writing.

It has been the longstanding practice of taxpayers and the IRS to appeal CDP, innocent spouse, and interest abatement cases to the circuit of the petitioner's legal residence, principal place of business, or principal office or agency. The Tax Court has also followed this approach. Under the rule established in *Golsen v. Commissioner*,<sup>59</sup> the Tax Court follows the precedent of the circuit court to which the parties have the right to appeal regardless of whether the taxpayer's tax liability was at issue.

49 IRC § 6330(d)(1).

50 *Giamelli v. Comm'r*, 129 T.C. 107 (2007).

51 Treas. Reg. §§ 301.6320-1(f)(2), Q&A (F)(3); 301.6330-1(f)(2), Q&A (F)(3).

52 *Churchill v. Comm'r*, T.C. Memo. 2011-182; see also CC-2013-002 (Nov. 30, 2012), which provides Counsel attorneys with instructions on when a remand based on changed circumstances might be appropriate.

53 See, e.g., *Pomeroy v. Comm'r*, T.C. Memo. 2013-26 at 20.

54 *Wadleigh v. Comm'r*, 134 T.C. 280, 299 (2010).

55 *De novo* means "anew." *De Novo*, BLACK'S LAW DICTIONARY (10th ed. 2014).

56 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. REP. NO. 1059-99, at 266. See also CC-2014-002 (May 4, 2014).

57 See, e.g., *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006); *Dalton v. Comm'r*, 682 F.3d 149 (1st Cir. 2012).

58 IRC § 7482(b)(1) also provides that the proper venue lies with the court of appeals for the circuit in which the taxpayer is located: in the case of a corporation seeking redetermination of tax liability, the principal place of business or principal office or agency of the corporation, or if it has no principal place of business or principal office or agency in any judicial circuit, then the office to which was made the return of the tax in respect of which the liability arises; in the case of a person seeking a declaratory decision under IRC § 7476, the principal place of business or principal office or agency of the employer; in the case of an organization seeking a declaratory decision under IRC § 7428, the principal office or agency of the organization; in the case of a petition under IRC §§ 6226, 6228(a), 6247, or 6252, the principal place of business of the partnership; and in the case of a petitioner under section IRC § 6234(c), (i) the legal residence of the petitioner if the petitioner is not a corporation, and (ii) the place or office applicable under subparagraph (B) if the petitioner is a corporation.

59 54 T.C. 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

In *Byers v. Commissioner*, the D.C. Circuit held that it will not transfer cases in non-liability CDP cases unless both parties stipulate to the transfer.<sup>60</sup> The D.C. Circuit did not answer the question of whether another Court of Appeals could hear an appeal of a non-liability CDP decision without stipulation.<sup>61</sup> The Court acknowledged that in some CDP cases involving both challenges to the tax liability and collection issues, the venue presumably would be in the appropriate regional circuit.<sup>62</sup>

*Byers* was overruled by the Protecting Americans from Tax Hikes (PATH) Act of 2015, enacted December 18, 2015.<sup>63</sup> Section 423 of the PATH Act added new subparagraph IRC § 7482(b)(1)(G), which specifies that CDP cases are appealable to the circuit of the petitioner's legal residence (if the petitioner is an individual) or the petitioner's principal place of business, office, or agency (if the petitioner is not an individual). According to section 423(b) of the PATH Act, the new subparagraph applies only to cases filed after December 18, 2015, but they should not be construed to create any inference regarding cases filed before that date.<sup>64</sup> In 2014, to address the uncertainty and confusion among taxpayers and practitioners that impact *the right to be informed*, the National Taxpayer Advocate recommended this precise legislative change to Congress.<sup>65</sup>

## ANALYSIS OF PUBLISHED OPINIONS

We identified and reviewed 99 CDP court opinions, a 25 percent increase from the 79 published opinions in last year's report. As shown in Figure 3.2.1, we have identified on average over 130 opinions per year since 2001.

From 2003 to 2007, the average number of published opinions was approximately 200. Since 2011, the average number of published opinions has dropped to about 94. This decline may seem to be attributed, in part, to a series of operational changes in fiscal years (FYs) 2011 and 2012, collectively known as the

60 740 F.3d 668 (D.C. Cir. 2014). For a more detailed discussion of the *Byers* case see National Taxpayer Advocate 2014 Annual Report to Congress 477-94 (Most Litigated Issue: *Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330*).

61 740 F.3d at 677. The Court noted that it had “no occasion to decide ... whether a taxpayer who is seeking review of a CDP decision on a collection method may file in a court of appeals other than the D.C. Circuit if the parties have not stipulated to venue in another circuit.”

62 *Id.* at 676.

63 Pub. L. No. 114-113, Div. Q, 129 Stat. 2242, 3041-3129 (2015). See IRS Office of Chief Counsel, Notice CC-2016-006, *PATH Act Legislative Amendments: Appellate Venue for CDP and Innocent Spouse Cases, Tax Court Jurisdiction and S-case Status for Interest Abatement Cases, and Applicability of Federal Rules of Evidence to the Tax Court* (Feb. 1, 2016), superseding CC-2015-006, *Venue for Appeals from Decisions of the Tax Court* (June 30, 2015).

64 For cases filed before that date, the guidance in CC-2015-006 applies.

65 See National Taxpayer Advocate 2014 Annual Report to Congress 387-91 (Legislative Recommendation: *Appellate Venue in Non-Liability CDP Cases: Amend IRC § 7482 to Provide That the Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies with the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides*).

“Fresh Start” initiative,<sup>66</sup> which led to fewer NFTL filings and more accepted OIC.<sup>67</sup> However, it is not clear that the reduction in CDP published opinions is attributable to the reduced number of lien filings. Furthermore, the annual number of CDP cases petitioned fluctuated inconsistently over this time.<sup>68</sup>

The increase in CDP cases received suggests that the reduced number of CDP opinions identified may not be the result of fewer taxpayers requesting a CDP hearing and then contesting the CDP determination by filing a Tax Court petition. Instead, it could be the result of more taxpayers deciding not to pursue litigation after filing a petition, more settlements, or more non-precedential CDP orders or bench opinions that do not result in a published opinion.<sup>69</sup> Moreover, the decline in litigated cases may be due to taxpayers litigating many issues of first impression in the years immediately following the enactment of IRC §§ 6320 and 6330, which now have been resolved by the courts.

Thus, the 99 published opinions identified this year do not reflect the full number of CDP cases.<sup>70</sup> Table 2 in Appendix 3 provides a detailed list of the published CDP opinions, including specific information about the issues, the types of taxpayers involved, and the outcomes of the cases.

### Litigation Success Rate

Taxpayers prevailed in full in ten of the 99 published opinions issued during the year ending May 31, 2016 (ten percent). Taxpayers prevailed in part in six other cases (six percent). Of the published opinions in which the courts found for the taxpayer, in whole or in part, the taxpayers appeared *pro se* in eight cases and were represented in eight cases. The IRS prevailed fully in 83 cases (approximately 84 percent) of the published opinions, an increase from the 82 percent last year.<sup>71</sup> The 16 percent success rate<sup>72</sup> for the taxpayer is one of the highest success rates since the inception of CDP hearings and may be an indication that the IRS is not addressing collection alternatives adequately at the administrative hearing.

66 See IRS, IR-2011-20, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes Made to Lien Process* (Feb. 24, 2011); IR-2012-31, *IRS Offers New Penalty Relief and Expanded Installment Agreements to Taxpayers under Expanded Fresh Start Initiative* (Mar. 7, 2012); IR-2012-53, *IRS Announces More Flexible Offer-in-Compromise Terms to Help a Greater Number of Struggling Taxpayers Make a Fresh Start* (May 21, 2012). See also National Taxpayer Advocate 2015 Annual Report to Congress 114, National Taxpayer Advocate 2012 Annual Report to Congress 348-51; National Taxpayer Advocate Fiscal Year (FY) 2013 Objectives Report to Congress 32-35.

67 For instance, in FY 2016, the IRS filed about 55 percent fewer NFTLs than in FY 2011, including a corresponding 58 percent reduction in liens filed by the Automated Collection System (ACS). In FY 2011, the IRS filed 1,042,230 liens. See IRS, Collection Activity Report 5000-23 (Oct. 11, 2011). In FY 2016, the IRS filed 470,602 liens. See IRS, Collection Activity Report 5000-25 (Oct. 4, 2016). Additionally, the dollars collected increased from about \$17 billion in FY 2011 to about \$20.2 billion in 2016. See IRS, Collection Activity Report 5000-2 (Oct. 3, 2011); IRS, Collection Activity Report 5000-6 (Oct. 3, 2011); IRS, Collection Activity Report 5000-108 (Oct. 5, 2011); IRS, Collection Activity Report 5000-2 (Oct. 3, 2016); IRS, Collection Activity Report 5000-6 (Oct. 3, 2016); IRS, Collection Activity Report 5000-108 (Oct. 4, 2016). We also note that the IRS has accepted 36 percent more OICs than during FY 2011, and that the actual number of accepted offers has almost doubled when compared to FY 2010, with FY 2016 having an acceptance rate of 40.4 percent. See IRS, Collection Activity Report 5000-108 (Oct. 5, 2010); IRS, Collection Activity Report 5000-108 (Oct. 5, 2011); IRS, Collection Activity Report 5000-108 (Oct. 4, 2016). During FY 2016, thousands of financially struggling taxpayers have successfully obtained lien withdrawals to help regain their financial viability. See IRS, Collection Activity Report 5000-25 Report (Oct. 4, 2016).

68 IRS Office of Chief Counsel Reports, CDP Cases Received Between June 1, 2000 and May 31, 2015 (on file with TAS).

69 For a discussion regarding the number of CDP unpublished opinions, see Carlton Smith, *Unpublished CDP Orders Dwarf Post-trial Bench Opinions in Uncounted Tax Court Rulings*, *PROCEDURALLY TAXING* (Jan. 29, 2015), <http://www.procedurallytaxing.com/unpublished-cdp-orders-dwarf-post-trial-bench-opinions-in-uncounted-tax-court-rulings/>.

70 See U.S. Tax Court, Orders Search, <https://www.ustaxcourt.gov/InternetOrders/OrdersSearch.aspx>.

71 National Taxpayer Advocate 2015 Annual Report to Congress 489 (Most Litigated Issue: *Appeals From Collection Due Process Hearings Under IRC § 6320 and 6330*).

72 The success rate includes decisions for the taxpayer as well as split decisions.

**FIGURE 3.2.1, Success Rates in Collection Due Process (CDP) Opinions Identified<sup>73</sup>**

| Court Decision       | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|----------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Decided for IRS      | 95%  | 95%  | 89%  | 90%  | 92%  | 90%  | 92%  | 89%  | 92%  | 86%  | 84%  | 89%  | 82%  | 84%  |
| Decided for Taxpayer | 1%   | 3%   | 8%   | 8%   | 5%   | 8%   | 4%   | 10%  | 3%   | 7%   | 8%   | 7%   | 14%  | 10%  |
| Split Decision       | 4%   | 2%   | 3%   | 2%   | 3%   | 2%   | 4%   | 2%   | 3%   | 6%   | 9%   | 4%   | 4%   | 6%   |
| Neither              | n/a  | n/a  | n/a  | n/a  | <1%  | n/a  | n/a  | n/a  | 1%   | <1%  | n/a  | n/a  | n/a  | n/a  |

### Issues Litigated

The cases discussed below are those the National Taxpayer Advocate considers significant or noteworthy. Their outcomes can provide important information to Congress, the IRS, and taxpayers about the rules and operation of CDP hearings. All of the cases offer the IRS an opportunity to improve the CDP process and collection practices in both application and execution.

#### *Ryskamp v. Commissioner*

In *Ryskamp v. Commissioner*, the IRS Office of Appeals sent a letter denying the taxpayer a CDP hearing.<sup>74</sup> The letter simply stated that the grounds upon which he requested a CDP hearing were frivolous or reflected a desire to delay or impede the administration of the federal tax laws.<sup>75</sup> In taxable years (TYs) 2003–2009, Mr. Ryskamp incurred tax liabilities because he did not have adequate withholding and failed to make estimated tax payments. In 2011, the IRS notified Mr. Ryskamp that it intended to levy his property in order to collect these delinquent liabilities. Mr. Ryskamp had submitted a CDP hearing request which was later lost by the IRS. The IRS rejected the request pursuant to IRC § 6330(g) stating that Mr. Ryskamp had not offered a legitimate reason for requesting a hearing and asked that he withdraw his frivolous positions and amend his request to provide a legitimate reason. Mr. Ryskamp submitted an amended request and attempted to state legitimate grounds. The AO disregarded Mr. Ryskamp's request and issued a “boilerplate” letter which did not contain a statement of reasons why the taxpayer's request was illegitimate.<sup>76</sup> Instead, the IRS letter recited the various possible reasons a position can be frivolous without specificity.

Having previously decided that the Tax Court had jurisdiction to review the IRS's frivolousness determination,<sup>77</sup> the Tax Court found the IRS's boilerplate letter rejecting Mr. Ryskamp's arguments as frivolous was inadequate and remanded the case to Appeals.

On remand from the Tax Court, Appeals gave the taxpayer another opportunity to submit a new CDP request. He did so, and raised both frivolous and non-frivolous arguments. Appeals held a hearing by

<sup>73</sup> Total percentages may not add to 100 percent, as a result of rounding.

<sup>74</sup> *Ryskamp v. Comm'r*, 797 F.3d 1142 (D.C. Cir. 2015), cert. denied, 136 U.S. 834 (2016).

<sup>75</sup> *Id.*

<sup>76</sup> The IRS's letter failed to identify any allegedly frivolous positions and lacked any explanation of how and whether the taxpayer's CDP request showed a desire to delay or impede tax administration. The Appeals letter “merely included a bullet point list of all of the possible reasons the [IRS] could find a request to be frivolous and did not correlate them with any aspects of Ryskamp's request.” *Ryskamp*, 797 F.3d at 1151.

<sup>77</sup> See *Thornberry v. Comm'r*, 136 T.C. 356 (2011) (the IRS's determination that a taxpayer's entire request for a CDP hearing is frivolous is subject to judicial review to verify the frivolousness determination).

correspondence, at which it rejected Mr. Ryskamp's frivolous positions and substantively considered his non-frivolous positions. Because Mr. Ryskamp refused to provide Appeals with necessary financial information and failed to offer any proof that he was in filing compliance, Appeals issued a notice of determination sustaining the IRS's proposal to levy. After remand, the Tax Court decided that Appeals did not abuse its discretion in concluding the IRS could proceed with collection action.

The taxpayer then appealed to the Court of Appeals for the District of Columbia. The IRS once again argued that the Tax Court lacked jurisdiction over an IRC § 6330(g) denial of a CDP hearing.

The D.C. Circuit reaffirmed the Tax Court's decision in *Thornberry*, concluding that the Tax Court's review is limited to assessing whether the IRS has adequately identified why it deems the taxpayer's CDP request, or portions thereof, to be frivolous, and whether that frivolousness assessment is facially plausible.<sup>78</sup> The court reasoned that this limited review would provide a safeguard against the IRS misconstruing or inadvertently overlooking a non-frivolous ("plausible or potentially meritorious") CDP request.<sup>79</sup>

The D.C. Circuit also affirmed the Tax Court's holding that the IRS's initial boilerplate determination letter denying the taxpayer's CDP hearing request was inadequate. It also found that the IRS abused its discretion in rejecting Ryskamp's request without first articulating the grounds of its frivolousness determination.<sup>80</sup>

However, the D.C. Circuit agreed with the Tax Court that on remand, Appeals provided the taxpayer with the opportunity to submit a new CDP request and adequately considered taxpayer's frivolous and non-frivolous arguments, concluding that the IRS could proceed with collection.

### *Charnas v. Commissioner*

In *Charnas v. Commissioner*, the IRS issued a notice of intent to levy to the taxpayer, a lawyer, whose main source of income was contingency fees from representing clients in personal injury actions.<sup>81</sup> The taxpayer timely requested a CDP hearing on Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, and checked boxes for all three collection alternatives.<sup>82</sup> The Settlement Officer (SO) scheduled a telephone CDP hearing and requested financial documentation for a collection alternative to be considered. Rather than sending in the documents, the taxpayer arrived at the IRS office with the documents in hand. The SO was on sick leave that day and not physically present at the office when the taxpayer arrived. The taxpayer left the financial documents at the IRS office and identified on the documents that his income varied widely from year to year due to the nature of his employment. The SO checked over the documents and denied the taxpayer a collection alternative based on the unexplained fluctuating income and sustained the levy action, without waiting for an explanation from the taxpayer.

<sup>78</sup> 136 T.C. at 367–69.

<sup>79</sup> *Ryskamp*, 797 F.3d at 1149.

<sup>80</sup> 797 F.3d at 1151.

<sup>81</sup> T.C. Memo. 2015-153.

<sup>82</sup> Form 12153 lists the following three items as collection alternatives: 1) Installment Agreement, 2) Offer in Compromise, and 3) I Cannot Pay Balance. See IRS Form 12153, *Requests for Collection Due Process or Equivalent Hearing* (Dec. 2013).

Additionally, the SO never afforded the taxpayer a face-to-face conference to explain his situation.<sup>83</sup> The taxpayer petitioned the Tax Court to review the SO's determination.

The Tax Court held that the SO acted arbitrarily and capriciously in rendering a determination against the taxpayer and remanded the case to Appeals. The court found that the SO did not weigh the taxpayer's fluctuating income in either the notice of determination or the case activity report when assessing the taxpayer's ability to pay. Additionally, the court found that the taxpayer presented relevant and non-frivolous reasons for disagreement with the proposed action and should have been given a "fair" hearing, providing him the opportunity to explain the significant fluctuations in his income.

The case is important because it reemphasizes the legislative requirement for Appeals to balance the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection action will be no more intrusive than necessary.<sup>84</sup> This opinion is in line with the *Budish* case where the court also remanded the case to Appeals for the failure to give proper attention to the balancing test in sustaining a collection action.<sup>85</sup> The Tax Court consistently views Appeals' failure to meaningfully perform the balancing test as an abuse of discretion.<sup>86</sup>

### *Abu-Dayeh v. Commissioner*

*Abu-Dayeh v. Commissioner* involves a tax preparer who pled guilty to aiding and assisting in the preparation of materially false and fraudulent tax returns.<sup>87</sup> In 2008, the taxpayer agreed to terms of a plea agreement to dismiss some of the counts against him, which required him to serve five months in prison and pay the IRS \$79,070 in restitution for the total tax losses due to the taxpayer's conduct.<sup>88</sup> The taxpayer paid all of the court-order restitution.

Later, in 2010, the IRS assessed multiple \$1,000 penalties under IRC § 6694(b) for understatements due to willful or reckless conduct by the tax return preparer.<sup>89</sup> The taxpayer protested the assessment by requesting a hearing with Appeals, and a conference was held on March 23, 2011. During the conference with Appeals, the taxpayer raised three defenses to the IRC § 6694(b) penalties:

- (1) He believed he had already paid the penalties as part of his restitution payment;
- (2) He believed the plea agreement covered all issues with respect to his preparation of the 39 fraudulent returns, and as a result it would be unfair for the IRS to assess civil penalties against him; and

83 In prior Annual Reports to Congress, and this report, the National Taxpayer Advocate criticizes Appeals for failing to provide face-to-face hearings to many taxpayers. See, e.g., Most Serious Problem: Appeals: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values, *supra*; National Taxpayer Advocate 2014 Annual Report to Congress 46-54 (Most Serious Problem: Appeals: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State).

84 IRC § 6330(c)(3)(C). See also National Taxpayer Advocate 2014 Annual Report to Congress 186-96 (Most Serious Problem: Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections).

85 *Budish v. Comm'r*, T.C. Memo. 2014-239.

86 See National Taxpayer Advocate 2014 Annual Report to Congress 186-96 (Most Serious Problem: Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections).

87 T.C. Memo. 2015-136.

88 See *United States v. Husam Abu-Dayeh*, No. 08-cr-00173-SCB-TBM (M.D.Fla., Apr. 22, 2009) (judgment in criminal case).

89 IRC § 6694(b). Taxpayer was assessed 36 separate \$1,000 penalties for returns prepared in taxable years 2003 to 2004.



- (3) His criminal proceedings had been handled by a special criminal investigation agent, and thus the IRS did not independently examine him for preparer penalties.

The AO determined the penalties were properly assessed.<sup>90</sup> The IRS issued a Letter 1058, *Final Notice of Intent to Levy and Notice of Your Right to a Hearing* on October 18, 2011, to which the taxpayer responded 31 days after the notice was mailed. On May 1, 2012, the IRS mailed to the taxpayer Letter 3172, *Notice of Federal Tax Lien Filing and Notice of Your Right to a Hearing Under IRC 6320*, and filed the NFTL on May 3, 2012. The taxpayer timely requested a CDP hearing. He also requested a withdrawal of the lien and checked the box for “I Cannot Pay Balance.”

The IRS SO held a CDP hearing telephonically, and the taxpayer challenged his underlying liability. The taxpayer also suggested an OIC in the amount of \$5,000, but did not submit an application fee or pay the initial required payment with a completed Form 656.<sup>91</sup> During the CDP process, the taxpayer repeatedly insisted to the SO that he had already paid any applicable penalties by virtue of having paid restitution in his criminal case. The Centralized Offer in Compromise (COIC) office returned the taxpayer’s OIC as not processable due to his failure to submit the application fee or required initial payment.

The SO issued the notice of determination to the taxpayer which sustained the NFTL; concluded that the taxpayer could not raise his underlying liability because he had a prior opportunity to do so; upheld the rejection of the OIC for failure to submit the required payments; and noted that the taxpayer had not proposed any other collection alternatives. The taxpayer petitioned the Tax Court to review the IRS’s determination.

The Tax Court upheld the SO’s determination that the taxpayer could not challenge the underlying liability in the CDP hearing because he had a prior opportunity to do so during his conference with the AO.<sup>92</sup> Because the validity of the underlying liability was not properly at issue, the Tax Court reviewed the SO’s administrative determination for abuse of discretion.<sup>93</sup>

In considering whether the IRS abused its discretion, the Tax Court looked at whether the SO considered any relevant issues raised at the hearing, and properly applied the CDP balancing test ensuring that any proposed collection action balanced the need for the efficient collection of taxes with petitioner’s legitimate concern that any collection action be no more intrusive than necessary.<sup>94</sup> While expressing empathy for the taxpayer, the Tax Court determined that the SO did not abuse her discretion in rejecting the taxpayer’s OIC because the taxpayer failed to pay the application fee, to make a partial payment of his proposed \$5,000 offer, and to submit supporting financial documents as required by IRC § 7122(c) and relevant Treasury Regulations.<sup>95</sup>

90 The AO determined that the taxpayer be properly assessed 36 total penalties of \$1,000 each based on the taxpayer’s admission of guilt as to 39 counts in his plea agreement and the fact that understatements of tax liability existed on only 36 of those counts.

91 See IRM 5.8.2.4.1, *Determining Processability* (July 28, 2015) (stating that an “OIC will be returned as not processable if one or more of the criteria below are present: ... • [t]axpayer did not submit the application fee with the offer[;] ... • [t]axpayer did not submit the required initial payment with the offer”).

92 IRC § 6330(c)(2)(B).

93 *Goza v. Comm’r*, 114 T.C. 176, 181–182 (2000).

94 See IRC §§ 6320(c)(1), 6330(c)(2) and (3)(A), (B), and (C).

95 IRC § 7122(c)(1) and (2)(B); Treas. Reg. § 301.7122–1(d)(1).

The opinion is important because it discusses the issue of contesting the underlying liability at the CDP hearing after the taxpayer has had a prior opportunity to dispute the liability.<sup>96</sup> It is important to note that the Tax Court verified that the SO properly conducted the CDP balancing test, which is an integral part of the taxpayer's *right to privacy*.

### *Yasgur v. Commissioner*

In *Yasgur v. Commissioner*, the Tax Court was asked to determine if a taxpayer, Mr. Yasgur, was precluded under IRC § 6330(c)(2)(B) from challenging the underlying tax liability because he either “received, was aware of, or deliberately failed to learn of” an April 30, 2005, levy notice issued to him.<sup>97</sup> This case involves the unique set of facts regarding the mailing location of the notices.

The taxpayer in question was married, but lived separately and had a distant relationship from his wife, despite the fact that they continued to file joint tax returns after establishing separate residences.<sup>98</sup> For these joint tax returns, including the year 2003 in question, the taxpayers listed the wife's residence, which was their jointly-owned home (“marital home”) 100 miles away from the taxpayer's residence. In addition to living separately, the taxpayers had a “cordial but distant relationship,” in which they would communicate sporadically and often go several months without any communication. The taxpayer stipulated that the marital home address was his “last known address” for purposes of taxes and admitted that the address was primarily used for correspondence related to federal and New York state taxes. The taxpayer's wife would generally forward any unopened mail addressed to Mr. Yasgur individually and would open jointly addressed mail and forward Mr. Yasgur a copy or the original.

In October 2004, the taxpayer filed a joint federal income tax return for 2003 indicating a tax due of \$60,801.<sup>99</sup> In January 2005, the IRS field office in Holtsville, NY had notified both the taxpayer and his wife of the amount owed in reported unpaid tax. The taxpayer swiftly contacted the collection manager and requested collection actions be stalled until the taxpayers could file an amended return. The collection manager suggested that Mr. Yasgur enter into an IA, a topic he discussed with his distant wife, until, at least, May 23, 2005. However, on April 30, 2005, the IRS Automated Collection System (ACS) Support office mailed, certified, separate notices of intent to levy to Mr. and Mrs. Yasgur, which Mrs. Yasgur picked up at the U.S. Post Office near her home. Mrs. Yasgur neither forwarded this notice to Mr. Yasgur nor requested a CDP hearing within the 30 day time period. Although Mr. Yasgur did not receive the April 30, 2005 notice or have knowledge of it prior to early August 2005, Mr. Yasgur contacted an attorney “regarding one or both of the notices of levy,” and, on August 17, 2005, the attorney requested a hearing with respect to the April 30, 2005 levy notice. The attorney sent a second letter to the IRS requesting another hearing with respect to the notice of lien filing, specifically a Letter 3172, *Notice of*

96 See, e.g., *Our Country Home Enters., Inc. v. Comm'r*, No. 16-1279 (7th Cir. Aug. 25, 2016) (reply brief of appellant) (arguing that the government's contention that the limitations of § 6330(c)(4) prohibited the Tax Court from determining the merits of the penalty assessment is contradictory towards IRS Chief Counsel memos and a prior argument made by Department of Justice, upheld in *Lewis v. Comm'r*, 128 T.C. 48 (2007), that courts should defer to regulation under § 6330(c)(2)(B)); *James v. Comm'r*, No. 16-1154 (4th Cir. Aug. 25, 2016) (reply brief of appellant) (same); and *Keller Tank Serv. v. Comm'r*, No. 16-9001 (10th Cir. Aug. 24, 2016) (reply brief of appellant) (same). These briefs also cite to the National Taxpayer Advocate's 2013, 2014, and 2015 Annual Reports to Congress for a discussion on the issues with “independence” by the Office of Appeals.

97 T.C. Memo. 2016-77.

98 A prior decision by the court had determined that the taxpayer's wife was precluded from challenging the existence or amount of the underlying tax liability for 2003 since she had prior opportunity to do so. *Yasgur v. Comm'r*, T.C. Memo. 2016-77.

99 The taxpayer's liability was primarily attributable to his reporting of passive income from his interest in a law partnership via a Schedule K-1 (Form 1065), *Partner's Share of Income, Credits, Deductions, etc.*, received before the extended due date of the 2003 return. The taxpayer believes the income was overstated and had a difficult relationship with his law partners so, at the advice of his accountant, they reported the income but intended to file an amended return when they could document Mr. Yasgur's claim of a lesser share of partnership income.

*Federal Tax Lien Filing and Your Rights to a Hearing Under IRC § 6320*, sent jointly to both Mr. and Mrs. Yasgur on August 16, 2005. In late September 2005, the taxpayers submitted an amended 2003 joint income tax return reflecting a lower tax liability and a refund request for almost \$4,000. Finally, on October 13, 2005, the taxpayer's attorney submitted a Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, requesting a hearing with respect to both the levy and lien notices.

The Appeals SO determined that the husband and wife's requests for a hearing were untimely with respect to both the lien and levy notices but did provide them with an equivalent hearing and issued a decision letter.<sup>100</sup> The decision letter determined that the taxpayers were not entitled to challenge the existence or amount of the underlying tax liability since they had prior opportunity to "discuss" the tax liability. The taxpayer petitioned the Tax Court that the determination made by Appeals to sustain the lien notice was an abuse of discretion since he had no unpaid tax liability for 2003, as shown on the amended return. The Tax Court held that Mr. Yasgur was entitled to challenge the underlying tax liability because he neither received prior notice of the levy nor deliberately refused the delivery of the notice.

The court looked to if Mr. Yasgur either "received, was aware of, or deliberately failed to learn of" the levy notice since, in cases where there is joint and several liability for an unpaid tax, the IRS must send a separate notice to each spouse whose property the IRS intends to levy, and the government has the burden of production to prove the taxpayer received the notice.<sup>101</sup> The taxpayer provided significant evidence to rebut the presumption of receipt, including the fact that the taxpayer did not reside at the marital home and his testimony. Specifically, the court did not agree with the government's assertion that since Mrs. Yasgur was aware of the levy, she "would undoubtedly have told him about something so serious and significant affecting their financial circumstances." The court determined that Mrs. Yasgur could have believed that the levy notices addressed the same issues that Mr. Yasgur was working with the Holtsville office on and failed to notify him. Furthermore, the court found evidence of Mr. Yasgur's tendency to be "punctilious and transparent" in his dealings with the IRS and this "pattern of conduct ... is at odds with the contention that [the taxpayer] ... received, or was aware of, the levy notice ... and simply ignored it." Finally, the court found no evidence of the IRS's alleged scheme where the taxpayer arranged to have all his IRS correspondence sent to the marital home while residing elsewhere so that he could disclaim knowledge of any notices. The Tax Court held that the taxpayer did not deliberately refuse delivery nor deliberately failed to learn of the levy notices and thus he did not have the prior opportunity to challenge the underlying tax liability.

The Tax Court opinion reveals the importance of the due process afforded to a taxpayer before a collection action can be sustained. If a taxpayer does not receive notice and does not deliberately thwart an attempt by the IRS to deliver a notice, then the taxpayer must be afforded his or her due process to challenge the underlying tax liabilities. Furthermore, this opinion shows the importance of the IRS's obligation to listen to the taxpayer, as the Tax Court did, instead of assuming the taxpayer is a bad actor. This is at the heart of the taxpayer's *right to challenge the IRS position and be heard*, since there is an obligation on the part of the IRS to listen to the taxpayer, and the *right to a fair and just tax system*, since the IRS failed to consider the specific facts and circumstances of the taxpayers' living situation.

100 Although the decision letter and SO determination was in respect to both the lien and the levy, the IRS conceded that the lien hearing request was timely and the Tax Court has jurisdiction. This was because the decision letter contained a determination with respect to the lien which may be reviewed by the Tax Court. See *Craig v. Comm'r*, 119 T.C. 252 (2002); cf. *Wilson v. Comm'r*, 113 T.C. 47 (2008) and *MacDonald v. Comm'r*, T.C. Memo. 2009-63.

101 See *Moorhouse v. Comm'r*, 116 T.C. 263, 271 (2001) (discussing the need for separate levy notice to each spouse).

## CONCLUSION

CDP hearings provide instrumental protections for taxpayers to meaningfully address the appropriateness of IRS collection actions. Given the important safeguard that CDP hearings offer taxpayers, it is unsurprising that CDP remains one of the most frequently litigated issues. The cases discussed this year were important for a variety of reasons.

The cases affirmed important protections for taxpayers, substantiated the Tax Court's test for abuse of discretion, and addressed procedural issues. The *Ryskamp* opinion confirmed the taxpayer's *right to challenge the IRS's position and be heard*. In *Ryskamp*, the court reaffirmed the Tax Court's holding in *Thornberry* and prevented the IRS from denying a CDP hearing by simply labeling the hearing request as entirely frivolous.<sup>102</sup> The opinion also validated a taxpayer's *right to be informed* because the court held that the IRS could not send standardized letters, but rather, must give some indication as to which issues raised by a taxpayer are frivolous.

Chief Counsel issued a notice changing the guidelines for handling frivolous CDP hearing requests under IRC § 6330(g) in response to *Ryskamp*.<sup>103</sup> Counsel attorneys will no longer file motions to dismiss, but rather motions to remand cases to Appeals for a substantive hearing to address legitimate issues if Counsel determines that the taxpayer raised at least one legitimate issue and the CDP hearing request should not have been denied in its entirety. The Tax Court in *Ryskamp* held that the IRS cannot send standardized letters and must articulate the bases of its denial under section 6330(g) by explaining why each argument of the taxpayer is not proper.<sup>104</sup> Counsel continues to disagree with the holdings in *Ryskamp* but recognized, in view of the settled Tax Court and D.C. Circuit law, that it would be a waste of Counsel resources to continue to contest Tax Court jurisdiction in those forums.

*Charnas* illustrates the importance of a taxpayer's *rights to privacy, to challenge the IRS's position and to be heard, and to a fair and just tax system* because the opinion reemphasizes the importance of the CDP balancing test.<sup>105</sup> Similar to the *Budish* case discussed in last year's report,<sup>106</sup> the *Charnas* court found that by failing to perform the proper balancing test, the IRS had abused its discretion in sustaining a levy. The *Charnas* and *Budish* decisions show the Tax Court's consistency in scrutinizing Appeals' determinations lacking elaboration or proper analysis. In *Charnas*, the Tax Court also concluded that a correspondence-only hearing was not sufficient to provide the taxpayer the fair hearing under IRC §§ 6330 and 6320. The *Charnas* decision pushes the IRS to live up to its commitment to provide face-to-face conferences

<sup>102</sup> *Thornberry v. Comm'r*, 136 T.C. 356, 367 (2011).

<sup>103</sup> Notice CC-2016-008 Subject: *Disregarding Frivolous CDP Hearing Requests Under Section 6330(g)* (Apr. 4, 2016).

<sup>104</sup> *Ryskamp v. Comm'r*, 797 F.3d 1142 (D.C. Cir. 2015), cert. denied, 136 U.S. 834 (2016). Cf. *Lunnon v. Comm'r*, T.C. Memo. 2015-156, *aff'd*, 117 A.F.T.R.2d (RIA) 2094 (10th Cir. 2016). In *Lunnon*, the taxpayer called the revenue officer handling the case the "spawn of Satan himself" and attached a 30-page frivolous document published by Truth Attack entitled "The Real Truth About the IRS's Truth About Frivolous Tax Arguments." Despite making frivolous arguments during the pre-CDP phase of the case, the taxpayer used neutral language in his CDP request disputing the proposed levy, requesting the withdrawal of the NFTL, and stating that he did not owe taxes. During the CDP conference despite the SO's warning Mr. Lunnon about making frivolous arguments, the taxpayer "wanted to discuss only constitutional challenges to his tax liabilities and how he disagreed with [RO's] 'intrusive' investigation." Nonetheless, the SO did not invoke IRC § 6330(g) but instead made a substantive determination on the merits. The Tax Court affirmed the Appeals' determination. The contrast of the handling these two cases shows that administering the frivolous provisions is a challenging task for Appeals employees facing a taxpayer who raises potentially frivolous issues and does not properly articulate legitimate arguments.

<sup>105</sup> IRC § 6330(c)(3)(C).

<sup>106</sup> See *Budish v. Comm'r*, T.C. Memo. 2014-230; see also National Taxpayer Advocate 2015 Annual Report to Congress 481-98 (Most Litigated Issue: *Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330*); National Taxpayer Advocate 2014 Annual Report to Congress 186-96.

with Appeals to taxpayers who present relevant, non-frivolous reasons for disagreement.<sup>107</sup> Moving away from *pro forma* statements and boilerplate language (without proper analysis) and encouraging hearing officers to fully consider relevant, non-frivolous issues in a face-to-face setting could go a long way in reducing future litigation. By not giving proper attention to the balancing test and conducting correspondence-only hearings, the IRS is missing opportunities to improve compliance, enhance taxpayer trust and confidence, relieve undue burden on taxpayers, and support the taxpayer's *right to privacy*.<sup>108</sup>

*Abu-Dayeh* is important because it identified the necessity of taxpayers to follow the procedural requirements of offering a collection alternative (*e.g.*, an OIC).<sup>109</sup> Thus taxpayers and the IRS are held accountable to the uniform procedural standards of the taxpayer's *right to a fair and just tax system* is protected.

*Yasgur* sheds important light on a taxpayer's *right to be informed, right to pay no more than the correct amount of tax, and the right to challenge the IRS's position and be heard*. If a taxpayer does not receive notice of an IRS collection action and does not deliberately prevent an attempt by the IRS to deliver the notice, then the taxpayer must be afforded his or her due process right to challenge the underlying tax liabilities.<sup>110</sup> A taxpayer may challenge the existence or amount of the underlying tax liability, but only if he or she did not receive a notice of deficiency with respect to the liability or otherwise have an opportunity to dispute the liability.<sup>111</sup> The IRS cannot assume taxpayers have had an opportunity to dispute the liability simply because a notice has been sent.

In sum, the CDP hearing is a powerful tool for taxpayers. Genuine two-way communication, rather than boilerplate letters, between the IRS and the taxpayer is crucial for the process to work properly. When taxpayers provide full documentation and develop a complete and comprehensive administrative record, they have a better chance of prevailing on Appeal and during judicial review. To reduce litigation in this area, the IRS Office of Appeals should commit to making substantive determinations in CDP cases properly considering the balancing test and all relevant, nonfrivolous issues, and better take into account all facts and circumstances. The IRS needs to thoroughly address the legitimate issues of a taxpayer disputing a collection action to further the taxpayer's *rights to be informed, to privacy, to pay no more than the correct amount of tax, to challenge the IRS's position and to be heard, to appeal an IRS decision in an independent forum, and to a fair and just tax system*.

107 Treas. Reg. § 301.6330-1(d)(2), Q&A D-7 (stating that "a taxpayer who presents in the CDP hearing request relevant, non-frivolous reasons for disagreement with the proposed levy will ordinarily be offered an opportunity for a face-to-face conference at the Appeals office closest to taxpayer's residence.").

108 See National Taxpayer Advocate 2014 Annual Report to Congress 185-96 (Most Serious Problem: *Collection Due Process: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*).

109 *Abu-Dayeh v. Comm'r*, T.C. Memo. 2015-136.

110 IRC § 6330(c)(2)(B).

111 *Id.*

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## Summons Enforcement Under IRC §§ 7602, 7604, and 7609

## SUMMARY

Pursuant to Internal Revenue Code (IRC) § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability.<sup>1</sup> To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information.<sup>2</sup> If a person summoned under IRC § 7602 neglects or refuses to obey the summons; to produce books, papers, records, or other data; or to give testimony as required by the summons, the IRS may seek enforcement of the summons in a United States district court.<sup>3</sup>

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it.<sup>4</sup> Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because often the government, rather than the taxpayer, initiates the litigation. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons.<sup>5</sup> Generally, the burden on the taxpayer to establish the illegality of the summons is heavy.<sup>6</sup> When challenging the summons's validity, the taxpayer generally must provide "some credible evidence" supporting an allegation of bad faith or improper purpose.<sup>7</sup> The taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons only when the taxpayer can point to specific facts or circumstances that plausibly raise an inference of bad faith.<sup>8</sup> Naked allegations of improper purpose are not enough, but because direct evidence of IRS's bad faith "is rarely if ever available," circumstantial evidence can suffice to meet that burden.<sup>9</sup>

We identified 87 federal cases decided between June 1, 2015, and May 31, 2016 involving IRS summons enforcement issues. The government was the initiating party in 58 cases, while the taxpayer was the initiating party in 29 cases. Overall, taxpayers fully prevailed in three cases, while five cases were split. The IRS prevailed in the remaining 79 cases.

1 Internal Revenue Code (IRC) § 7602(a)(1); Treas. Reg. § 301.7602-1.

2 IRC § 7602(a).

3 IRC § 7604(b).

4 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

5 IRC § 7609(b).

6 *U.S. v. LaSalle Nat'l Bank*, 437 U.S. 298, 316 (1978).

7 *U.S. v. Clarke*, 134 S. Ct. 2361, 2367 (2014), *vacating* 517 F. App'x 689 (11th Cir. 2013), *rev'g* 2012-2 U.S. Tax Cas. (CCH) ¶ 50,732 (S.D. Fla. 2012).

8 *Id.* (stating that "[t]he taxpayer need only make a showing of facts that give rise to a plausible inference of improper motive").

9 *Id.* at 2367-68.



## TAXPAYER RIGHTS IMPACTED<sup>10</sup>

- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

## PRESENT LAW

The IRS has broad authority under IRC § 7602 to issue a summons to examine a taxpayer's books and records or demand testimony under oath.<sup>11</sup> Further, the IRS may obtain information related to an investigation from a third party if, subject to the exceptions of IRC § 7609(c), it provides notice to the taxpayer or other person identified in the summons.<sup>12</sup> In limited circumstances, the IRS can issue a summons even if the name of the taxpayer under investigation is unknown, *i.e.*, a “John Doe” summons.<sup>13</sup> However, the IRS cannot issue a summons after referring the matter to the Department of Justice (DOJ).<sup>14</sup>

If the recipient fails to comply with a summons, the United States may commence an action under IRC § 7604 in the appropriate U.S. District Court to compel document production or testimony.<sup>15</sup> If the United States files a petition to enforce the summons, the taxpayer may contest the validity of the summons in that proceeding.<sup>16</sup> Also, if the summons is served upon a third party, any person entitled to notice may petition to quash the summons in an appropriate district court, and may intervene in any proceeding regarding the enforceability of the summons.<sup>17</sup>

Generally, a taxpayer or other person named in a third-party summons is entitled to notice.<sup>18</sup> However, the IRS does not have to provide notice in certain situations. For example, the IRS is not required to give notice if the summons is issued to aid in the collection of “an assessment made or judgment rendered against the person with respect to whose liability the summons is issued.”<sup>19</sup> Congress created this exception because it recognized a difference between a summons issued in an attempt to compute the taxpayer's taxable income and a summons issued after the IRS has assessed tax or obtained a judgment.

10 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

11 IRC § 7602(a). See also *LaMura v. U.S.*, 765 F.2d 974, 979 (11th Cir. 1985) (citing *U.S. v. Bisceglia*, 420 U.S. 141, 145-46 (1975)).

12 IRC § 7602(c). Those entitled to notice of a third-party summons (other than the person summoned) must be given notice of the summons within three days of the day on which the summons is served to the third party but no later than the 23rd day before the day fixed on the summons on which the records will be reviewed. IRC § 7609(a).

13 The court must approve a “John Doe” summons prior to issuance. In order for the court to approve the summons, the United States commences an *ex parte* proceeding. The United States must establish during the proceeding that its investigation relates to an ascertainable class of persons; it has a reasonable basis for the belief that these unknown taxpayers may have failed to comply with the tax laws; and it cannot obtain the information from another readily available source. IRC § 7609(f).

14 IRC § 7602(d). This restriction applies to “any summons, with respect to any person if a [DOJ] referral is in effect with respect to such person.” IRC § 7602(d)(1).

15 IRC § 7604.

16 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

17 IRC § 7609(b). The petition to quash must be filed not later than the 20th day after the date on which the notice was served. IRC § 7609(b)(2)(A).

18 IRC § 7609(a)(1); Treas. Reg. § 301.7609-1(a)(1). See, e.g., *Cephas v. U.S.*, 112 A.F.T.R.2d (RIA) 6483 (D. Md. 2013).

19 IRC § 7609(c)(2)(D)(i). The exception also applies to the collection of a liability of “any transferee or fiduciary of any person referred to in clause (i).” IRC § 7609(c)(2)(D)(ii).

For example, the IRS does not have to give notice to the taxpayer or person named in the summons if it is attempting to determine whether the taxpayer has an account in a certain bank with sufficient funds to pay an assessed tax because such notice might seriously impede the IRS's ability to collect the tax.<sup>20</sup> Courts have interpreted this "aid in collection" exception to apply only if the taxpayer owns a legally identifiable interest in the account or other property for which records are summoned.<sup>21</sup> Additionally, the IRS is not required to give notice when, in connection with a criminal investigation, an IRS criminal investigator serves a summons on any person who is not the third-party record-keeper.<sup>22</sup>

Whether the taxpayer contests the summons in a motion to quash or in response to the United States' petition to enforce, the legal standard is the same.<sup>23</sup> In *United States v. Powell*, the Supreme Court set forth four threshold requirements (referred to as the *Powell* requirements) that must be satisfied to enforce an IRS summons:

1. The investigation must be conducted for a legitimate purpose;
2. The information sought must be relevant to that purpose;
3. The IRS must not already possess the information; and
4. All required administrative steps must have been taken.<sup>24</sup>

The IRS bears the initial burden of establishing that these requirements have been satisfied.<sup>25</sup> The government meets its burden by providing a sworn affidavit of the agent who issued the summons declaring that each of the *Powell* requirements has been satisfied.<sup>26</sup> The burden then shifts to the person contesting the summons to demonstrate that the IRS did not meet the requirements or that enforcement of the summons would be an abuse of process.<sup>27</sup>

The taxpayer can show that enforcement of the summons would be an abuse of process if he or she can prove that the IRS issued the summons in bad faith.<sup>28</sup> In *United States v. Clarke*, the Supreme Court held that during a summons enforcement proceeding, a taxpayer has a right to conduct an examination of the responsible IRS officials about whether a summons was issued for an improper purpose only when the taxpayer "can point to specific facts or circumstances plausibly raising an inference of bad faith."<sup>29</sup> Blanket claims of improper purpose are not sufficient, but circumstantial evidence can be.<sup>30</sup>

20 H.R. REP. NO. 94-658 at 310, *reprinted in* 1976 U.S.C.C.A.N. at 3206. See also S. REP. NO. 94-938, pt. 1, at 371, *reprinted in* 1976 U.S.C.C.A.N. at 3800-01 (containing essentially the same language).

21 *Ip v. U.S.*, 205 F.3d 1168, 1172-76 (9th Cir. 2000).

22 IRC § 7609(c)(2)(E). A third-party record-keeper is broadly defined and includes banks, consumer reporting agencies, persons extending credit by credit cards, brokers, attorneys, accountants, enrolled agents, and owners or developers of computer source code but only when the summons "seeks the production of the source or the program or the data to which the source relates." IRC § 7603(b)(2).

23 *Kamp v. U.S.*, 112 A.F.T.R.2d (RIA) 6630 (E.D. Cal. 2013).

24 *U.S. v. Powell*, 379 U.S. 48, 57-58 (1964).

25 *Fortney v. U.S.*, 59 F.3d 117, 119-20 (9th Cir. 1995).

26 *U.S. v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993).

27 *Id.*

28 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

29 *U.S. v. Clarke*, 134 S. Ct. 2361, 2367 (2014), *vacating* 517 F. App'x 689 (11th Cir. 2013), *rev'g* 2012-2 U.S. Tax Cas. (CCH) ¶ 50,732 (S.D. Fla. 2012).

30 *Id.* at 2367-68.

A taxpayer may also allege that the information requested is protected by a constitutional, statutory, or common-law privilege, such as the:

- Fifth Amendment privilege against self-incrimination;
- Attorney-client privilege;<sup>31</sup>
- Tax practitioner privilege;<sup>32</sup> or
- Work product privilege.<sup>33</sup>

However, these privileges are limited. For example, courts reject blanket assertions of the Fifth Amendment,<sup>34</sup> but note that taxpayers may have valid Fifth Amendment claims regarding specific documents or testimony.<sup>35</sup> However, even if a taxpayer may assert the Fifth Amendment on behalf of him or herself, he or she cannot assert it on behalf of a business entity.<sup>36</sup>

Additionally, taxpayers cannot, on the basis of the Fifth Amendment privilege, withhold self-incriminatory evidence of a testimonial or communicative nature if the summoned documents fall within the “foregone conclusion” exception to the Fifth Amendment. The exception applies if the government establishes its independent knowledge of three elements:

1. The documents’ existence;
2. The documents’ authenticity; and
3. The possession or control of the documents by the person to whom the summons was issued.<sup>37</sup>

The attorney-client privilege protects “tax advice,” but not tax return preparation materials.<sup>38</sup> The “tax shelter” exception limits the tax practitioner privilege and permits discovery of communications between a practitioner and client that promote participation in any tax shelter.<sup>39</sup> Thus, the tax practitioner privilege does not apply to any written communication between a federally authorized tax practitioner and “any person, any director, officer, employee, agent, or representative of the person, or any other person holding a capital or profits interest in the person” which is “in connection with the promotion of the direct or indirect participation of the person in any tax shelter.”<sup>40</sup>

31 The attorney-client privilege provides protection from discovery of information where: (1) legal advice of any kind is sought, (2) from a professional legal advisor in his or her capacity as such, (3) the communication is related to this purpose, (4) made in confidence, (5) by the client, (6) and at the client’s insistence protected, (7) from disclosure by the client or the legal advisor, (8) except where the privilege is waived. *U.S. v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing 8 JOHN HENRY WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2292 (John T. McNaughten rev. 1961)).

32 IRC § 7525 extends the protection of the common law attorney-client privilege to federally authorized tax practitioners in federal tax matters. Criminal tax matters and communications regarding tax shelters are exceptions to the privilege. IRC § 7525(a)(2), (b). The interpretation of the tax practitioner privilege is based on the common law rules of attorney-client privilege. *U.S. v. BDO Seidman, LLP*, 337 F.3d 802, 810-12 (7th Cir. 2003).

33 The work product privilege protects against the discovery of documents and other tangible materials prepared in anticipation of litigation. FED. R. CIV. P. 26(b)(3); see also *Hickman v. Taylor*, 329 U.S. 495 (1947).

34 See, e.g., *U.S. v. McClintic*, 113 A.F.T.R.2d (RIA) 330 (D. Or. 2013).

35 See, e.g., *U.S. v. Lawrence*, 113 A.F.T.R.2d (RIA) 1933 (S.D. Fla. 2014).

36 See, e.g., *U.S. v. Ali*, 113 A.F.T.R.2d (RIA) 1863 (D. Md. 2014) (citing *U.S. v. Wujkowski*, 929 F.2d 981, 983 (4th Cir. 1991)).

37 *U.S. v. Bright*, 596 F.3d 683, 692 (9th Cir. 2010).

38 *U.S. v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999).

39 IRC § 7525(b). See also *Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009).

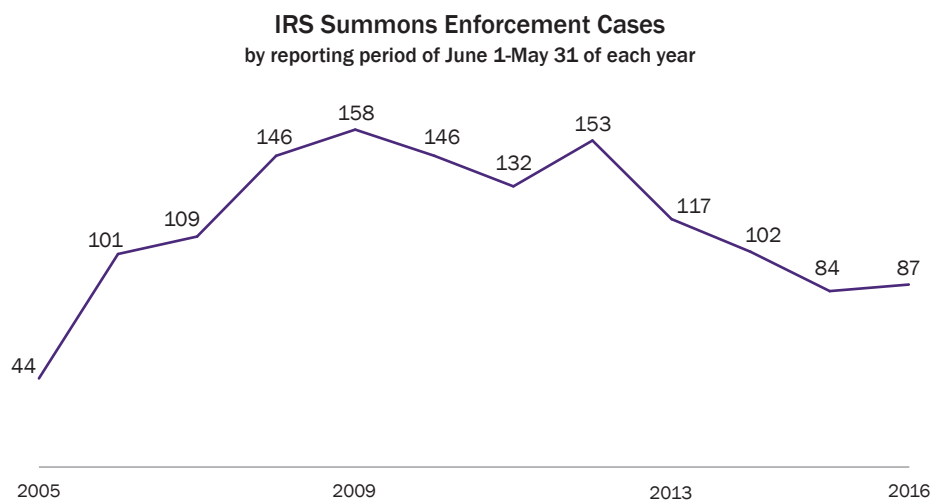
40 *Id.* A tax shelter is defined as “a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.” IRC § 6662(d)(2)(C)(ii).

In July 2016, the IRS issued final regulations providing that outside parties with whom the IRS or the Office of Chief Counsel contracts for services — such as economists, engineers, consultants, or attorneys — may receive books papers, records, or other data summoned by the IRS and, in the presence of an IRS officer or employee, participate fully in the interview of a person who the IRS has summoned as a witness to provide testimony under oath.<sup>41</sup>

## ANALYSIS OF LITIGATED CASES

Summons enforcement has been a Most Litigated Issue in the National Taxpayer Advocate's Annual Report to Congress every year since 2005, when TAS identified only 44 cases but predicted the number would rise as the IRS became more aggressive in its enforcement initiatives. The number of cases peaked at 158 for the reporting period ending on May 31, 2009, but had steadily declined, except for a one-year increase for the year ending May 31, 2012, as shown in Figure 3.3.1. This year, the number of summons enforcement cases picked up slightly, as we identified 87 cases for the reporting period ending on May 31, 2016, an increase from the 84 cases we identified during last year's reporting period. A detailed list of these cases appears in Table 3 of Appendix 3.

**FIGURE 3.3.1**



Of the 87 cases TAS reviewed this year, the IRS prevailed in full in 79, a 91 percent success rate, which is a slight decline from the IRS's 96 percent success rate during the 2015 reporting period.<sup>42</sup> Taxpayers had representation in 38 cases (44 percent) and appeared *pro se* (*i.e.*, on their own behalf) in the remaining 49. This is a notable climb in the number of represented taxpayers as only 27 percent of taxpayers were represented during last year's reporting period.<sup>43</sup> Seventy-two cases involved individual taxpayers, while

<sup>41</sup> See Treas. Reg. § 301.7602-1(b)(3). As we noted in last year's Annual Report, the IRS issued temporary regulations on this topic in June 2014. See Temp. Treas. Reg. § 301.7602-1T(b)(3); National Taxpayer Advocate 2015 Annual Report to Congress 470-71. These temporary regulations were the subject of summons enforcement litigation involving the IRS's use of an outside law firm in an audit of Microsoft Corporation's transfer pricing arrangements, a case that will be discussed below.

<sup>42</sup> See National Taxpayer Advocate 2015 Annual Report to Congress 471.

<sup>43</sup> *Id.*

the remaining 15 involved business taxpayers, including sole proprietorships.<sup>44</sup> Cases generally involved one of the following themes.

### Petitions to Enforce and *Powell* Requirements

The United States petitioned to enforce a summons in 58 cases and successfully met its burden under *Powell* in 57 cases.<sup>45</sup> In only one case, *United States v. Lamotte*, did the IRS fail to satisfy the *Powell* requirements.<sup>46</sup> In *Lamotte*, the IRS issued two summonses to Mr. Lamotte, who was the treasurer of Northern Tree Service, Inc. (Northern) and director of two captive insurance companies that provided insurance to Northern. One of the summons sought documents and the other testimony relating to Northern's utilization of a captive insurance tax structure.<sup>47</sup>

With respect to the summons requesting documents, Mr. Lamotte argued that the IRS was already in possession of the documents.<sup>48</sup> The district court agreed, finding that the IRS already had the documents it sought and was therefore not entitled to a summons enforcement order under *Powell*.<sup>49</sup>

### Petitions to Quash and Lack of Subject Matter Jurisdiction

Taxpayers petitioned to quash an IRS summons to a third party in 29 instances;<sup>50</sup> however, in most of these cases, courts dismissed the petitions for lack of jurisdiction on procedural or notice grounds. For example, two United States Courts of Appeals affirmed district court dismissals of a taxpayer's petition to quash a summons issued to the taxpayer's bank because the summons was to aid in the collection of a tax liability, and the taxpayer was therefore not entitled to notice.<sup>51</sup>

In *Haber v. United States*, the taxpayer filed a petition to quash an IRS summons served on a bank that sought documents and testimony relating to assets held by the taxpayer's wife, which the district court dismissed for lack of subject matter jurisdiction because the United States has not waived sovereign immunity to allow suits to quash summonses that are issued to aid in the collection of an assessed tax.<sup>52</sup> On appeal to the Second Circuit, the taxpayer argued that, because he had brought various legal challenges to the assessment which prevented the IRS from beginning actual collection, the summons

44 There were cases in which the IRS issued summons for investigations into both the individual taxpayer and his or her business. For the purposes of this MLI, TAS placed these cases into the business taxpayer category.

45 See, e.g., *Davis & Campbell, LLC v. U.S.*, 116 A.F.T.R.2d (RIA) 7124 (S.D.N.Y. 2015); *Neuberger v. U.S.*, 2016 U.S. Dist. LEXIS 59371 (W.D. Pa. 2016); *Wood v. U.S.*, 117 A.F.T.R.2d (RIA) 1919 (D. Md. 2016).

46 *U.S. v. Lamotte*, 117 A.F.T.R.2d (RIA) 1725 (D. Mass. 2016), *adopting* 117 A.F.T.R.2d (RIA) 1718 (D. Mass. 2016), *appeal dismissed*, No. 16-1940 (1st Cir. August 2, 2016).

47 *Id.*, *adopting* 117 A.F.T.R.2d (RIA) 1718 (D. Mass. 2016), *appeal dismissed*, No. 16-1940 (1st Cir. August 2, 2016). A captive insurance structure is where a business sets up an insurance company to protect against certain risks. While this may be structured with legitimate tax benefits, there are situations where it can be abused. See IRS, *Abusive Tax Shelters Again on the IRS "Dirty Dozen" List of Tax Scams for the 2016 Filing Season* (Feb. 16, 2016), [https://www.irs.gov/uac/newsroom/abusive-tax-shelters-again-on-the-irs-dirty-dozen-list-of-tax-scams-for-the-2016-filing-season?\\_ga=1.49174374.1518734088.1474380960](https://www.irs.gov/uac/newsroom/abusive-tax-shelters-again-on-the-irs-dirty-dozen-list-of-tax-scams-for-the-2016-filing-season?_ga=1.49174374.1518734088.1474380960).

48 With respect to the summons seeking testimony, the court declined to enforce that summons because, as will be discussed below, Mr. Lamotte had properly invoked the Fifth Amendment privilege.

49 *U.S. v. Lamotte*, 117 A.F.T.R.2d (RIA) 1725 (D. Mass. 2016), *adopting* 117 A.F.T.R.2d (RIA) 1718 (D. Mass. 2016), *appeal dismissed*, No. 16-1940 (1st Cir. August 2, 2016).

50 In some instances, the taxpayer made the motion to quash in its answer to the government's petition to enforce.

51 *Haber v. U.S.*, 823 F.3d 746 (2d Cir. 2016), *aff'g* 115 A.F.T.R.2d (RIA) 2221 (S.D.N.Y. 2015); *Maehr v. Comm'r*, 641 F. App'x 813 (10th Cir. 2016), *aff'g* 116 A.F.T.R.2d (RIA) 5398 (D. Colo. 2015). Under IRC § 7609(c)(2)(D)(i), the IRS is not required to provide notice to the taxpayer and the taxpayer therefore has no right to quash the summons if the summons is issued to aid in the collection of the taxpayer's liability.

52 *Haber v. U.S.*, 115 A.F.T.R.2d (RIA) 2221 (S.D.N.Y. 2015), *aff'd* 823 F.3d 746 (2d Cir. 2016).

was not issued to aid in collection, and thus, he should be able to quash the summons.<sup>53</sup> The court disagreed, analyzing the language of the statute under IRC § 7609(c)(2)(D), and finding that there was no requirement that IRS have “present authority to collect on the assessment or the actual collection is ‘imminent.’”<sup>54</sup> The court therefore affirmed the lower court’s dismissal of the taxpayer’s petition to quash.<sup>55</sup>

Similarly, in *Maehr v. Commissioner*, the Tenth Circuit affirmed a district court dismissal of a taxpayer’s petition to quash a summons served on his bank.<sup>56</sup> The appellate court found that, because the summons was issued to aid in the collection of an assessment under IRC § 7609(c)(2)(D), the IRS was not required to give notice to the taxpayer and he was therefore not permitted to quash the summons.<sup>57</sup>

### Privileges

As in past years, taxpayers attempted to invoke various privileges, including Fifth Amendment, attorney-client, or other privileges in response to an IRS summons. For example, two United States Courts of Appeals, in cases of first impression before each circuit, agreed with the unanimous view of the other Courts of Appeals that had considered the issue and held that records required to be kept under the Bank Secrecy Act fell within the required records exception to the Fifth Amendment privilege.<sup>58</sup>

In *United States v. Chabot*, the IRS issued summonses to the taxpayers to give testimony and produce documents relating to their foreign bank accounts for the 2006 through 2009 tax years, which it then amended and narrowed to foreign bank account documents required to be kept under 31 C.F.R. § 1010.420.<sup>59</sup> The taxpayers did not comply with the summons, claiming that doing so might subject them to prosecution for failing to provide this information in annual Report of Foreign Bank and Financial Account filings. They also claimed that the required records exception to the Fifth Amendment privilege should not apply to their case.<sup>60</sup> The district court found that the required records exception applied and granted the government’s petition to enforce the summons. On appeal, the court found that the required records exception trumped the taxpayers’ Fifth Amendment privilege claim and affirmed the district court’s granting of the Government’s petition to enforce the summons.<sup>61</sup>

In a similar case, *United States v. Chen*, the First Circuit held that foreign banking records required to be kept under the Bank Secrecy Act fell within the required records exception to the Fifth Amendment privilege and thus were subject to the summonses.<sup>62</sup> However, with respect to other documents for which

53 *Haber v. U.S.*, 823 F.3d 746 (2d Cir. 2016), *aff’g* 115 A.F.T.R.2d (RIA) 2221 (S.D.N.Y. 2015).

54 *Id.*

55 *Id.* The court also dismissed the taxpayer’s contention that the IRS’s issuance of the summons was improper because a Department of Justice referral was in effect under IRC § 7602(d) and that the taxpayer was entitled to jurisdictional discovery.

56 *Maehr v. Comm’r*, 641 F. App’x 813 (10th Cir. 2016), *aff’g* 116 A.F.T.R.2d (RIA) 5398 (D. Colo. 2015).

57 *Id.* The appellate court noted that it was affirming the decision of the district court but for a different reason. The court stated that the district court had found that it lacked subject matter jurisdiction because the taxpayer’s motion to quash was not brought timely under IRC § 7609(b)(2), which requires a taxpayer to bring suit within 20 days after the IRS gives notice. However, the appellate court emphasized that the taxpayer was not entitled to notice in the first place but reached the same result as the district court.

58 *U.S. v. Chabot*, 793 F.3d 338 (3d Cir. 2015), *aff’g* 114 A.F.T.R.2d (RIA) 6235 (D.N.J.), *cert. denied*, 136 S. Ct. 559 (2015); *U.S. v. Chen*, 815 F.3d 72 (1st Cir. 2016), *aff’g in part, vacating in part, and remanding* 952 F.Supp.2d 321 (D.Mass. 2013).

59 *U.S. v. Chabot*, 793 F.3d 338 (3d Cir. 2015), *aff’g* 114 A.F.T.R.2d (RIA) 6235 (D.N.J.), *cert. denied*, 136 S. Ct. 559 (2015).

60 The required records exception to the Fifth Amendment privilege against self-incrimination excludes from the protection of the privilege certain records that an individual is required by law to keep.

61 *Id.*

62 *U.S. v. Chen*, 815 F.3d 72 (1st Cir. 2016), *aff’g in part, vacating in part, and remanding* 952 F.Supp.2d 321 (D.Mass. 2013).



the taxpayer had claimed Fifth Amendment privilege, the court vacated the decision of the district court and remanded the case because the district court had not provided an explanation of why it had denied the taxpayer's privilege claims.<sup>63</sup>

However, taxpayers were in some cases successful in asserting privileges. For example, as discussed above, in *United States v. Lamotte*, the IRS issued two summonses to Mr. Lamotte, one seeking documents and the other testimony relating to the taxpayer's utilization of a captive insurance tax structure.<sup>64</sup> As noted earlier, the court found that the IRS already had possession of the documents it sought and was therefore not entitled to a summons enforcement order with respect to the summons seeking documents.<sup>65</sup> Moreover, with respect to the IRS summons for Mr. Lamotte's testimony, the court found that he had properly invoked his Fifth Amendment privilege against self incrimination, as "the incriminating nature of the testimony sought by the government is evident on its face."<sup>66</sup>

### Civil Contempt

A taxpayer who "neglects or refuses to obey" an IRS summons may be held in civil contempt.<sup>67</sup> This year, six taxpayers were held in civil contempt for failing to comply with a court order enforcing an IRS summons.<sup>68</sup> Overall, contempt proceedings accounted for approximately seven percent of all summons-related cases. Unless the taxpayers complied with the court order, they were subject to arrest,<sup>69</sup> fines,<sup>70</sup> or both.<sup>71</sup>

### The Clarke Case Revisited

The *Clarke* litigation continues as the taxpayers maintained their litigation push for an evidentiary hearing after the Supreme Court's 2014 decision that set the standard for obtaining such a hearing.<sup>72</sup> After that decision, the case was remanded to the District Court for the Southern District of Florida, which denied the taxpayers' request for an evidentiary hearing and enforced the summons. On appeal, the Eleventh Circuit affirmed, holding that the fact that the summoned information might assist the IRS in preparing

63 *U.S. v. Chen*, 815 F.3d 72 (1st Cir. 2016), *aff'g in part, vacating in part, and remanding* 952 F.Supp.2d 321 (D.Mass. 2013).

64 *U.S. v. Lamotte*, 117 A.F.T.R.2d (RIA) 1725 (D. Mass. 2016), *adopting* 117 A.F.T.R.2d (RIA) 1718 (D. Mass. 2016), *appeal dismissed*, No. 16-1940 (1st Cir. August 2, 2016).

65 *Id.*

66 *Id.*, *adopting* 117 A.F.T.R.2d (RIA) 1718 (D. Mass. 2016), *appeal dismissed*, No. 16-1940 (1st Cir. August 2, 2016). In another case involving privilege, *Schaeffler v. U.S.*, 806 F.3d 34 (2d Cir. 2015), *vacating and remanding* 22 F. Supp. 3d 319 (S.D.N.Y. 2014), *dismissed as moot*, 117 A.F.T.R.2d (RIA) 2139 (S.D.N.Y. 2016), the Second Circuit found that the taxpayer had not waived the attorney-client privilege by sharing documents with a consortium of banks that had common legal interest with the taxpayer. The court also found that the work-product doctrine protected documents prepared at a time when the taxpayer believed that litigation was highly probable. However, the IRS subsequently withdrew the summons and the district court dismissed the case as moot.

67 IRC § 7604(b).

68 See *U.S. v. Anderson*, 117 A.F.T.R.2d (RIA) 1174 (N.D. Cal. 2016); *U.S. v. Belcik*, 117 A.F.T.R.2d (RIA) 926 (M.D. Fla. 2016), *adopting in part* 117 A.F.T.R.2d (RIA) 922 (M.D. Fla. 2016); *U.S. v. Butler*, 2016 U.S. Dist. LEXIS 59179 (W.D. Ky. 2016); *U.S. v. Singh*, 117 A.F.T.R.2d (RIA) 1069 (E.D. Cal. 2016), *enforcing* 116 A.F.T.R.2d (RIA) 5313 (E.D. Cal. 2015); *U.S. v. Soong*, 116 A.F.T.R.2d 5792 (N.D. Cal. 2015), *granting motion for civil contempt sanctions*, 113 A.F.T.R.2d (RIA) 1589 (N.D. Cal. 2014), *aff'd by* 117 A.F.T.R.2d (RIA) 1801 (9th Cir. 2016); *U.S. v. Thornton*, 621 F. App'x. 360 (8th Cir. 2015), *aff'g* 115 A.F.T.R.2d (RIA) 1258 (D. Minn. 2015), *cert. denied*, 136 S. Ct. 2424 (2016).

69 *U.S. v. Belcik*, 117 A.F.T.R.2d (RIA) 926 (M.D. Fla. 2016), *adopting in part* 117 A.F.T.R.2d (RIA) 922 (M.D. Fla. 2016).

70 *U.S. v. Soong*, 116 A.F.T.R.2d 5792 (N.D. Cal. 2015), *granting motion for civil contempt sanctions*, 113 A.F.T.R.2d (RIA) 1589 (N.D. Cal. 2014), *aff'd by* 117 A.F.T.R.2d (RIA) 1801 (9th Cir. 2016).

71 *U.S. v. Butler*, 2016 U.S. Dist. LEXIS 59179 (W.D. Ky. 2016).

72 *U.S. v. Clarke*, 816 F. 3d 1310 (11th Cir. 2016), *aff'g* 115 A.F.T.R.2d (RIA) 836 (S.D. Fla. 2015), *on remand from* 573 F. App'x 826 (11th Cir. 2014), *on remand from* 134 S. Ct. 2361 (2014), *vacating and remanding* 517 F. App'x 689 (11th Cir. 2013), *petition for cert. filed*, No. 16-358 (Sept. 19, 2016).

for tax court litigation did not make its motive improper, that the district court did not abuse its discretion by opting not to hold a status conference or permit additional evidence before determining if the IRS's motive was improper, and that the taxpayers' allegations failed to point to the IRS's bad faith or improper motive.<sup>73</sup> The taxpayers have once again petitioned for *certiorari*.<sup>74</sup>

### The Continued Impact of *United States v. Clarke* and *Microsoft* Litigation

The Supreme Court's decision in *Clarke* continued to have an impact on summons litigation, as taxpayers sought evidentiary hearings to challenge a summons. Most of these efforts were unsuccessful.<sup>75</sup> However, as discussed in this section last year, in *United States v. Microsoft*, Microsoft Corporation was successful in obtaining an evidentiary hearing in a summons enforcement case where the IRS used an outside law firm to assist in an audit of the company.<sup>76</sup> In that case, the court found that, by asserting that the IRS was improperly delegating an inherently governmental function to a third party, Microsoft had met its burden under *Clarke* and was entitled to an evidentiary hearing.<sup>77</sup>

While Microsoft was successful in obtaining an evidentiary hearing, the IRS was ultimately successful in having the summons enforced.<sup>78</sup> In an opinion subsequent to the one granting the evidentiary hearing, although the court was "troubled" by the level of the outside law firm's involvement in the audit of the taxpayer, it concluded that this delegation of authority was not legally prohibited by IRC § 7602 and therefore granted the IRS's petition to enforce the summons.<sup>79</sup>

Finally, as noted earlier, the IRS issued final regulations in July 2016 providing that outside parties with whom the IRS or the Office of Chief Counsel contracts for services — such as economists, engineers, consultants, or attorneys — may receive books papers, records, or other data summoned by the IRS and, in the presence of an IRS officer or employee, participate fully in the interview of a person who the IRS has summoned as a witness to provide testimony under oath.<sup>80</sup> Also of note is that members of both the House and Senate have introduced legislation that would prohibit individuals who are not IRS employees from receiving summoned records or taking summoned testimony.<sup>81</sup>

73 *U.S. v. Clarke*, 816 F.3d 1310 (11th Cir. 2016), *aff'g* 115 A.F.T.R.2d (RIA) 836 (S.D. Fla. 2015), *on remand from* 573 F. App'x 826 (11th Cir. 2014), *on remand from* 134 S. Ct. 2361 (2014), *vacating and remanding* 517 F. App'x 689 (11th Cir. 2013), *petition for cert. filed*, No. 16-358 (Sept. 19, 2016).

74 *Id.*

75 See, e.g., *Highland Capital Mgmt., L.P. v. U.S.*, 626 F. App'x 324 (2d Cir. 2015), *aff'g in part, vacating in part, and remanding in part* 51 F. Supp. 3d 544 (S.D.N.Y. 2014); *Gangi v. U.S.*, 638 F. App'x 16 (1st Cir. 2016), *aff'g* 2 F.Supp.3d 12 (D.Mass. 2014).

76 See National Taxpayer Advocate 2015 Annual Report to Congress 471; *U.S. v. Microsoft Corp.*, 115 A.F.T.R.2d (RIA) 2186 (W.D. Wash. 2015).

77 *U.S. v. Microsoft Corp.*, 115 A.F.T.R.2d (RIA) 2186 (W.D. Wash. 2015).

78 *U.S. v. Microsoft Corp.*, 154 F.Supp.3d 1134 (W.D. Wash. 2015).

79 *Id.* However, it appears that this litigation may not be over as Microsoft has withheld documents due to privilege claims. See *Microsoft Withholding Documents in IRS Summons Enforcement Case*, TAX NOTES TODAY (Sep. 14, 2016).

80 See Treas. Reg. § 301.7602-1(b)(3).

81 See Tax Administration Integrity Act, H.R. 3167, § 2, 114th Cong. (2015); Taxpayer Protection Act of 2016, S. 3156, § 135, 114th Cong. (2016).

## CONCLUSION

The IRS may issue a summons to obtain information to determine whether a tax return is correct or if a return should have been filed to ascertain a taxpayer's tax liability or to collect a liability.<sup>82</sup> Accordingly, the IRS may request documents and testimony from taxpayers who have failed to provide that information voluntarily.

Summons enforcement continues to be a significant source of litigation and the number of litigated cases rose slightly from last year. The IRS also continues to be successful in the vast majority of summons enforcement litigation. Taxpayers and third parties rarely succeed in contesting IRS summonses due to the significant burden of proof and strict procedural requirements.

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<sup>82</sup> IRC § 7602(a).

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## Gross Income Under IRC § 61 and Related Sections

## SUMMARY

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress.<sup>1</sup> For this report, we reviewed 81 cases decided between June 1, 2015, and May 31, 2016. Several of the cases involved taxpayers failing to report items of income, including some specifically mentioned in Internal Revenue Code (IRC) § 61 such as wages,<sup>2</sup> interest,<sup>3</sup> dividends,<sup>4</sup> and annuities.<sup>5</sup>

TAXPAYER RIGHTS IMPACTED<sup>6</sup>

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

## PRESENT LAW

IRC § 61 broadly defines gross income as “all income from whatever source derived.”<sup>7</sup> The U.S. Supreme Court has defined gross income as any accession to wealth.<sup>8</sup> Over time, however, Congress has carved out numerous exceptions and exclusions from this broad definition of gross income and has based other elements of tax law on the definition.<sup>9</sup>

The Commissioner of Internal Revenue may identify particular items of unreported income or reconstruct a taxpayer's gross income using methods such as the bank deposits method.<sup>10</sup> If the Commissioner of Internal Revenue determines a tax deficiency, the IRS issues a Statutory Notice

1 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 476-80 (Most Litigated Issue: *Gross Income Under IRC § 61 and Related Sections*); National Taxpayer Advocate 2014 Annual Report to Congress 472-76 (Most Litigated Issue: *Gross Income Under IRC § 61 and Related Sections*); National Taxpayer Advocate 2013 Annual Report to Congress 355-61 (Most Litigated Issue: *Gross Income Under IRC § 61 and Related Sections*).

2 Internal Revenue Code (IRC) § 61(a)(1). See, e.g., *Green v. Comm'r*, T.C. Memo. 2016-67.

3 IRC § 61(a)(4). See, e.g., *Friedman v. Comm'r*, T.C. Memo. 2015-177.

4 IRC § 61(a)(7). See, e.g., *Bell v. Comm'r*, T.C. Memo. 2015-111, *appeal docketed*, No. 16-70166 (9th Cir. Jan. 19, 2016).

5 IRC § 61(a)(9). See, e.g., *Tobias v. Comm'r*, T.C. Memo. 2015-164.

6 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a), 129 Stat. 2242, 3117 (2015) (codified at IRC § 7803(a)(3)).

7 IRC § 61(a).

8 *Comm'r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955) (interpreting § 22 of the IRC of 1939, the predecessor to IRC § 61).

9 See, e.g., IRC § 104 (compensation for injuries or sickness); IRC § 105 (amounts received under accident and health plans); IRC § 108 (income from discharge of indebtedness); IRC § 6501 (limits on assessment and collection, determination of “substantial omission” from gross income).

10 IRC § 6001. See, e.g., *DiLeo v. Comm'r*, 96 T.C. 858, 867 (1991).

of Deficiency.<sup>11</sup> If the taxpayer challenges the deficiency, the Commissioner's notice is entitled to a presumption of correctness; the taxpayer generally bears the burden of proving that the determination is erroneous or inaccurate.<sup>12</sup>

## ANALYSIS OF LITIGATED CASES

In the 81 opinions involving gross income issued by the federal courts and reviewed for this report, gross income issues most often fall into two categories: (1) what is included in gross income under IRC § 61 and (2) what can be excluded under other statutory provisions. A detailed list of the cases appears in Table 4 of Appendix 3.

In 32 cases (40 percent), taxpayers were represented, while the rest were *pro se* (without counsel). Represented taxpayers prevailed in full or in part in five of 32 cases (16 percent), whereas *pro se* taxpayers prevailed in full or in part in three of 49 cases (six percent). Overall, taxpayers prevailed in full or in part in eight of 81 cases (ten percent).

Drawing on the full list in Table 4 of Appendix 3, we have chosen to discuss cases involving damage awards, disability benefits, Individual Retirement Account (IRA) distributions, cancellation of debt income, and the recognition of income from participation in a compensatory split-dollar life insurance arrangement.

### Damage Awards

Taxation of damage awards continues to generate litigation. This year, taxpayers in at least four cases (five percent of those reviewed) challenged the Commissioner's inclusion of damage awards in their gross income, but no taxpayers prevailed in these cases.<sup>13</sup>

IRC § 104(a)(2) specifies that damage awards and settlement proceeds<sup>14</sup> are taxable as gross income unless the award was received "on account of personal physical injuries or physical sickness."<sup>15</sup> Congress added the "physical injuries or physical sickness" requirement in 1996;<sup>16</sup> until then, the word "physical" did not appear in the statute. The legislative history of the 1996 amendments to IRC § 104(a)(2) provides that "[i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness ... [but] emotional distress is not considered a physical injury or physical sickness."<sup>17</sup> Thus,

11 IRC § 6212. See also Internal Revenue Manual (IRM) 4.8.9.2, *Notice of Deficiency Definition* (Aug. 11, 2016).

12 See IRC § 7491(a) (stating that the burden shifts only where the taxpayer produces credible evidence contradicting the Commissioner's determination and satisfies other requirements). See also *Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted).

13 In *Smallwood*, the taxpayer appealed the district court's grant of summary judgment in favor of the United States. The Court of Appeals for the Federal Circuit concluded that the district court failed to make a determination of what dollar amount of the taxpayer's settlement proceeds was attributable to her physical injuries or physical sickness within the meaning of § 104(a)(2) and therefore excludible from gross income, and consequently vacated and remanded the case to the district court for further proceedings. While the case is characterized as a win for the taxpayer in Table X.X, whether the taxpayer will prevail on the merits will be determined in a further proceeding.

14 See Treas. Reg. § 1.104-1(c) (damages received, for purposes of IRC § 104(a)(2), means amounts received "through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of such prosecution").

15 IRC § 104(a)(2).

16 Pub. L. No. 104-188, § 1605(a), 110 Stat. 1755, 1838 (1996).

17 H.R. REP. NO. 104-586, at 143-44 (1996) (Conf. Rep.).

damage awards for emotional distress are not considered as received on account of physical injury or physical sickness, even if the emotional distress results in “insomnia, headaches, [or] stomach disorders.”<sup>18</sup>

To justify exclusion from income under IRC § 104, the taxpayer must show settlement proceeds are in lieu of damages for physical injury or sickness, and this is frequently difficult to prove unless explicit in the damage award.<sup>19</sup> In *O'Connor v. Commissioner*, the taxpayer petitioned the Tax Court, and later appealed to the U.S. Court of Appeals for the Ninth Circuit, to exclude from his gross income payments he received from Covance Clinical Research Unit, Inc., for his participation in a gout medical study.<sup>20</sup> The taxpayer argued that the payment should be excluded from gross income as compensation received on account of physical injury or physical sickness.<sup>21</sup> The gout study required the taxpayer to spend ten days confined to a medical facility where he adhered to a strict schedule including blood tests, urine tests, electrocardiograms, and vital screenings. He was also required to participate in outpatient visits after the inpatient stay was completed. The taxpayer received a Form 1099-MISC, *Miscellaneous Income*, from Covance but did not report the \$5,550 received on his 2008 Form 1040, *U.S. Individual Income Tax Return*.

As discussed above, the court looks for a “direct causal link” between the damages received and the physical injury or sickness sustained.<sup>22</sup> However, because the taxpayer did not allege that he suffered physical injury or sickness on account of the study and had even suffered from gout before participating in the study, the court determined that he had not established a “direct causal link” between the payment and the gout from which he suffered. Furthermore, the taxpayer failed to produce the written contract with Covance to participate in the study and, due to this failure, the court held that “[m]ere participation in [a] study does not result in compensation for damages received on account of physical injury or physical sickness.”<sup>23</sup> As a result, the Ninth Circuit affirmed the Tax Court’s decision that the payment for the taxpayer’s participation in a medical research study was not excludible from gross income.<sup>24</sup> This appellate-level decision demonstrates that the courts look to the specific language of a settlement agreement or contract to determine whether damages are attributable to a physical injury or sickness sustained. Similarly, in *Dulanto v. Commissioner*, the Tax Court looked to the nature of the claim that was the actual basis for the settlement and rejected the taxpayer’s position that the damages the former employer paid as part of the settlement agreement for the resolution of claims in a class action lawsuit were not included in gross income.<sup>25</sup>

As illustrated by continuing litigation of the characterization of settlement damages, the question of when damage awards can be excluded from gross income continues to confuse taxpayers. Although we did not identify any cases this year in which the courts specifically addressed mental illness, the National Taxpayer Advocate remains concerned that taxpayers continue to disagree with the IRS and courts’ interpretation that mental illness equates to emotional distress as opposed to physical sickness or injury. In the same

18 H.R. REP. NO. 104-737, at 301 (1996) (Conf. Rep.). Note, however, that IRC § 104(a)(2) excludes from income damages, up to the cost of medical treatment for which a deduction under IRC § 213 was allowed for any prior taxable year, for mental or emotional distress causing physical injury.

19 See, e.g., *Green v. Comm’r*, 507 F.3d 857 (5th Cir. 2007), *aff’g* T.C. Memo. 2005-250.

20 *O’Connor v. Comm’r*, 606 F. App’x 390 (9th Cir. 2015), *aff’g* T.C. Memo. 2012-317.

21 In the alternative, the taxpayer argued that the payment should be treated as a gift, under IRC § 102(a), which allows the exclusion from gross income the value of property acquired by gift, bequest, devise, or inheritance.

22 See *Lindsey v. Commissioner*, 422 F.3d 684, 688 (8th Cir. 2005), *aff’g* T.C. Memo. 2004-113.

23 *O’Connor v. Comm’r*, T.C. Memo. 2012-317.

24 *O’Connor v. Comm’r*, 606 F. App’x 390, 391 (9th Cir. 2015), *aff’g* T.C. Memo. 2012-317.

25 *Dulanto v. Comm’r*, T.C. Memo. 2016-34 (citing *U.S. v. Burke*, 504 U.S. 229, 237 (1992), *appeal docketed*, No. 16-72867 (9th Cir. Aug. 29, 2016)).



way that a physical injury or sickness may have mental or emotional side effects, many mental illnesses manifest themselves as physical symptoms. For instance, many people who have severe depression experience the following physical symptoms: stomachaches, indigestion, constant headaches, tightness in the chest, difficulty breathing, and fatigue.<sup>26</sup> Physical symptoms occur in other mental disorders, such as Post-Traumatic Stress Disorder (PTSD), which affects people who have experienced a traumatic event, such as mugging, rape, torture, being kidnapped or held captive, child abuse, car accidents, train wrecks, plane crashes, bombings, natural or human-caused disasters, or military combat.<sup>27</sup> Current research shows that the experience of trauma can cause neurochemical changes in the brain that create a vulnerability to hypertension and atherosclerotic heart disease, abnormalities in thyroid and other hormone functions, and increased susceptibility to infections and immunologic disorders that are associated with PTSD.<sup>28</sup> As discussed in the 2009 Annual Report to Congress, the interpretation that mental illness equates to emotional distress seems particularly outdated when considering the medical advancements in understanding the physical cause and symptoms of mental illness.<sup>29</sup>

### Social Security and Disability Benefits

Taxpayers often litigate the characterization of Social Security and other types of disability benefits because portions of these benefits may be excludible from gross income.<sup>30</sup> In *Campbell v. Commissioner*, the taxpayers were retired Los Angeles County firefighters with service-connected disabilities.<sup>31</sup> The taxpayers were entitled to receive a disability pension and a service retirement pension. The taxpayers argued that all of pension compensation, rather than a portion, should be exempt from tax under IRC § 104(a)(1), which excludes from gross income “amounts received under workmen’s compensation acts as compensation for personal injury or sickness”.<sup>32</sup> Under California law, if the firefighter also qualifies for a service retirement pension, based on the length of time worked, in an amount greater than the disability pension, the firefighter will receive the full service retirement pension. Although the taxpayers initially reported the pension payments on their returns, they subsequently filed refund claims on the basis that all the pension payments received were connected to a disability and therefore not taxable. After the IRS denied the refund claims, the taxpayers filed refund suits. The district court concluded that the portion of a firefighter’s service pension amount exceeding the guaranteed disability pension amount is not excludable from income and is therefore taxable. The taxpayers then challenged the IRS’s authority to issue Treasury Regulation § 1.104-1(b), which states that the exclusion under IRC § 104(a)(1) does not apply if the “retirement pension [amount] ... is determined by reference to the employee’s age or length of service ... even though the ... retirement is occasioned by an occupational

26 National Institute of Mental Health, *Signs and Symptoms of Depression*, <https://www.nimh.nih.gov/health/topics/depression/index.shtml> (last visited Sept. 1, 2016).

27 National Institute of Mental Health, *Post-Traumatic Stress Disorder*, <http://www.nimh.nih.gov/health/topics/post-traumatic-stress-disorder-ptsd/index.shtml> (last visited Sept. 1, 2016).

28 See U.S. Department of Veterans Affairs, *National Center for PTSD*, <http://www.ptsd.va.gov/professional/co-occurring/ptsd-physical-health.asp> (last visited Sept. 1, 2016).

29 National Taxpayer Advocate 2009 Annual Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*). The National Taxpayer Advocate recommended that Congress amend IRC § 104(a)(2) to exclude from gross income payments received as settlement for mental anguish, emotional distress, and pain and suffering. Such change was recommended because mental anguish, emotional distress, and pain and suffering can be caused by a physical condition in the body and can cause physical symptoms. Over the past few years, doctors and researchers have made significant advances in identifying changes that occur in the brain when a person is plagued with mental illness.

30 See, e.g., *Campbell v. U.S.*, 607 F. App’x 697 (9th Cir. 2015), *aff’g* 111 A.F.T.R.2d (RIA) 946 (C.D. Cal. 2013); *Shakir v. Comm’r*, T.C. Memo. 2015-147.

31 607 F. App’x 697 (9th Cir. 2015), *aff’g* 111 A.F.T.R.2d (RIA) 946 (C.D. Cal. 2013).

32 *Campbell v. U.S.*, 607 F. App’x 697 (9th Cir. 2015), *aff’g* 111 A.F.T.R.2d (RIA) 946 (C.D. Cal. 2013).

injury ...” The U.S. Court of Appeals for the Ninth Circuit held that the IRS had the authority to issue this regulation and affirmed the district court’s holding that the taxpayers were not entitled to a refund. As this case demonstrates, the characterization of Social Security and other disability benefits continues to be a disputed issue.

### Individual Retirement Account (IRA) Distributions

IRC § 61(a) defines gross income as “all income from whatever source derived, including (but not limited to) ... (9) Annuities; ... and (11) Pensions.”<sup>33</sup> IRC § 408(d)(1) governs the tax treatment of distributions from individual retirement accounts (IRAs) and provides that they are generally included in gross income as amounts received as an annuity under IRC § 72.

Taxpayers in at least 12 cases argued that portions of their IRA distributions, pensions, or retirement accounts were excluded from gross income, prevailing in one case. In *McGaugh v. Commissioner*, the taxpayer had a self-directed IRA with Merrill Lynch as the custodian, and requested that Merrill Lynch purchase additional stock in a corporation; however, Merrill Lynch refused to purchase the stock directly, despite the fact it was not a prohibited transaction.<sup>34</sup> The taxpayer requested that Merrill Lynch issue a wire transfer to the corporation in which he wished to purchase stock, and, after sixty days the corporation issued the stock in the name of the taxpayer’s IRA. Merrill Lynch reported the transaction to the IRS due to its determination that the wire transfer was a distribution and not a rollover, and the IRS agreed. The Tax Court found that there was no “literal distribution” of the IRA funds to the taxpayer since he did not receive any cash, check, or wire transfer as the funds were sent to the corporation directly. Additionally, the Tax Court disagreed with the IRS’s assertion that, by wiring the funds at the instructions of the taxpayer, Merrill Lynch had put the funds at the taxpayer’s discretion, and found that at most the taxpayer was simply a conduit of the IRA funds, and thus the money was not includable as gross income.

In at least three cases this year, taxpayers challenged the taxability of distributions, specifically that the “rollover provisions” under IRC § 408(d) applied.<sup>35</sup> The “rollover provision” generally excludes from gross income IRA distributions that are transferred into an eligible retirement account within 60 days of receipt.<sup>36</sup> Taxpayers are limited under IRC § 408(d)(3)(B) to one nontaxable rollover per year.<sup>37</sup> Taxpayers are also only allowed to take advantage of the “rollover provision” as long as the transfer is not a prohibited transaction under IRC § 4975.

In *Thiessen v. Commissioner*, the taxpayers engaged in a prohibited transaction under IRC § 4975(c)(1)(B) and thus their transfer of funds from one IRA to another was not a “rollover” and was deemed to be a taxable distribution.<sup>38</sup> In 2003, the taxpayers attempted to “rollover” funds from a preexisting IRA to a self-directed IRA, and use those funds to acquire initial stock of a C corporation, with the taxpayers listed as the only officers and directors, which would in turn purchase a new business, all while the taxpayers

33 IRC § 61(a).

34 *McGaugh v. Comm’r*, T.C. Memo. 2016-28, appeal docketed, No. 16-2987 (7th Cir. July 21, 2016).

35 See, e.g., *McGaugh v. Comm’r*, T.C. Memo. 2016-28, appeal docketed, No. 16-2987 (7th Cir. July 21, 2016); *Thiessen v. Comm’r*, 146 T.C. 100 (2016); *Vandenbosch v. Comm’r*, T.C. Memo. 2016-29.

36 IRC § 408(d)(3)(A)(i), (ii); *Schoof v. Comm’r*, 110 T.C. 1, 7 (1998).

37 IRC § 408(d)(3)(B).

38 *Thiessen v. Comm’r*, 146 T.C. 100 (2016).

were personally guarantying repayment of the loan from the seller.<sup>39</sup> Seven years later, the taxpayers received a notice of deficiency due to the disqualification of the IRA from the “prohibited transaction.” Under § 4975(c)(1)(B), a “prohibited transaction” is “any direct or indirect ... lending of money or other extension of credit between a plan and a disqualified person,” with a “disqualified person” including any “fiduciary,” which is a person who “exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets.”<sup>40</sup> The court agreed with the IRS’s argument that the taxpayers’ guaranties of the loan were prohibited transactions under § 4975(c)(1)(B) since the guaranties were the taxpayers’ “indirect extensions of credit to [the taxpayers’] IRAs and that [the taxpayers’] participation in the prohibited transactions caused the IRAs to lose their status as IRAs.” Consequently, a taxable distribution occurred.<sup>41</sup> This is an important case due to the challenges surrounding IRA finance structuring and the complexity of rollover rules for IRAs.

The IRS recently issued guidance to address the problem of rollovers that missed this 60-day window.<sup>42</sup> A taxpayer is now allowed to self-certify (subject to verification on audit) that he or she is eligible for a waiver of the 60-day requirement instead of seeking a costly private letter ruling.<sup>43</sup> The revenue procedure provides 11 reasons for missing the deadline that are eligible for self-certification. It also provides a model letter that may be used for the self-certification. The National Taxpayer Advocate applauds the IRS for this change, which promotes taxpayers’ *right to a fair and just tax system*. It is likely that this change to a self-certification process will lead to a decrease in litigation in cases involving the 60-day rollover time frame. For example, had this revenue procedure been in place when the taxpayer in the *McGaugh*<sup>44</sup> case withdrew funds from his IRA, the taxpayer would probably have been able to self-certify.

### Discharge of Indebtedness

We reviewed four cases in which taxpayers disputed the IRS’s determination that discharge of indebtedness was taxable income. A taxpayer’s gross income generally includes income from a discharge of indebtedness.<sup>45</sup> However, under certain circumstances, a taxpayer can exclude the amount of discharged indebtedness from gross income under IRC § 108(a). IRC § 108(a) provides, subject to limitation, that a taxpayer may exclude income from the discharge of indebtedness if the discharge occurs during bankruptcy, when the taxpayer is insolvent, if the indebtedness is qualified farm or business real estate debt, or if the indebtedness is qualified principal residence indebtedness discharged before January 1, 2017, or subject to an arrangement that is entered into and evidenced in writing before January 1, 2017.<sup>46</sup> The creditor may issue a Form 1099-C, *Cancellation of Debt*, to the taxpayer for

39 The taxpayers used an IRA funding structure, discussed above, to purchase a business, and did so at the advice of a certified professional accountant. The taxpayers filed a joint Form 1040, *U.S. Individual Income Tax Return*, for 2003 and reported the IRA distributions but stated they were “ROLLOVER,” and had no taxable IRA distributions or tax specifically related to the IRA. An important note is that the joint return did not disclose the personal guarantee of the taxpayers on the loan or put the IRS on notice of the nature and amount of any deemed distribution resulting from the guaranties, nor did it disclose the C corporation or the 2003 Form 1120, *U.S. Corporate Income Tax Return*, filed.

40 IRC §§ 4975(e)(2)(A), (e)(3)(A). See also IRC §§ 4795(e)(2)(F), (e)(6) (stating that the spouse of a “disqualified person” is also a “disqualified person”).

41 *Thiessen v. Comm’r*, 146 T.C. 100 (2016). See IRC § 408(e)(2)(A) (providing that “[i]f, during any taxable year of the individual for whose benefit any [IRA] is established, that individual or his beneficiary engages in any transaction prohibited by [§] 4975 with respect to such account, such account ceases to be an [IRA] as of the first day of such taxable year.”).

42 See Rev. Proc. 2016-47, 2016-37 I.R.B. 346, modifying Rev. Proc. 2003-16, 2003-4 I.R.B. 359.

43 *Id.*

44 *McGaugh v. Comm’r*, T.C. Memo. 2016-28, *appeal docketed*, No. 16-2987 (7th Cir. July 21, 2016).

45 IRC § 61(a)(12).

46 IRC § 108(a)(1)(A)-(E).

canceled debts of \$600 or more.<sup>47</sup> If a creditor has discharged a debt the taxpayer owes, the taxpayer must include the discharged amount in gross income, even if it is less than \$600 or a Form 1099-C is not received, unless one of the exceptions in IRC § 108(a) applies. The issuance of a Form 1099-C is not dispositive of whether or when the debt is actually discharged.<sup>48</sup> A debt is deemed to have been discharged, and a Form 1099-C is required, if and only if, an “identifiable event” has occurred.<sup>49</sup>

In *Clark v. Commissioner*, the taxpayer had entered into a retail installment contract with a car dealership to purchase a car in 1999; however, by 2005, the taxpayer had defaulted on the contract and the vehicle was repossessed and sold at auction.<sup>50</sup> The terms of the retail installment contract provided that the seller could sell the repossessed car and the seller’s ability to assign all rights of the contract, without recourse, to AmeriCredit. After the repossession and sale of the car, AmeriCredit attempted to collect the debt of \$4,496.71, and assigned it to five separate third-party debt collectors between 2006 and June 29, 2011. In 2011, AmeriCredit reported a Form 1099-C discharging the taxpayer’s debt of \$4,496.71, but the taxpayer did not report any discharge of indebtedness income on her 2011 Form 1040.

In the petition to the Tax Court, the taxpayer, who was represented, alleged numerous arguments, with the case turning on the argument about the timing of the “identifiable event.” The taxpayer argued that the “identifiable event” occurred when AmeriCredit failed to receive payment on the debt after 36 months (December 2008), and the cancellation should have applied to 2008, which was the “expiration of the non-payment testing period” under Treasury Regulation § 1.6050P-1(b)(2)(i)(H). Under the relevant legal authority, there is a rebuttable presumption that an identifiable event has occurred during a calendar year if a creditor has not received a payment on a debt at any time during the testing period, generally 36 months, ending at the close of the year.<sup>51</sup> The IRS argued, however, that because AmeriCredit took collection actions during the testing period, the presumption that the identifiable event occurred in 2008 is negated. The IRS relied on evidence of business records showing the debt being assigned, at different times, to five third-party debt collectors. No evidence, however, was introduced regarding what, if any, actions any of the assigned debt collectors took to collect the debt. Due to the IRS’s failure to provide evidence of “any significant, bona fide activity that would indicate an active creditor,” the court found that the IRS had failed to rebut the presumption of the identifiable event discharging the taxpayer’s debt occurring in 2008, and not in 2011.

47 IRS, *Instructions for Form 1099-A and 1099-C Acquisition or Abandonment of Secured Property and Cancellation of Debt*, <https://www.irs.gov/pub/irs-pdf/i1099ac.pdf> (Sept. 30, 2015).

48 *Kleber v. Comm’r*, T.C. Memo. 2011-233 (citation omitted).

49 Treas. Reg. §§ 1.6050P-1(a)(1), (b)(2)(i)(A)-(H) (describing different scenarios that signify when an “identifiable event” has occurred). See also *Friedman v. Comm’r*, 216 F.3d 547-49 (6th Cir. 2000), *aff’d* T.C. Memo. 1998-196.

50 *Clark v. Comm’r*, T.C. Memo. 2015-175.

51 See Treas. Reg. § 1.6060P-1(b)(2)(iv). Note that the IRS has issued final regulations which eliminate the 36-month testing period for information returns required to be filed, and payee statements required to be furnished, after December 31, 2016. 81 FR 78908 (Nov. 10, 2016). See also National Taxpayer Advocate 2010 Annual Report to Congress 383-86 (Legislative Recommendation: Remove the 36-Month “Testing Period” that May Trigger Cancellation of Debt Reporting).

## Recognition of Income From Participation in Compensatory Split-Dollar Life Insurance Arrangements

In *Our Country Home Enterprises, Inc. v. Commissioner*, the Tax Court reviewed seven consolidated cases relating to income tax deficiencies from the inclusion of income from a “purported” welfare benefit plan, the Sterling Benefit Plan.<sup>52</sup> The Tax Court first determined that the life insurance policies issued on the shareholders and employees (the individuals) as part of their participation in the Sterling Benefit Plan was a compensatory split-dollar life insurance arrangement.<sup>53</sup> A split-dollar life insurance arrangement is an arrangement between an owner of a life insurance contract and a nonowner of the contract (other than group term life insurance), under which either party to the arrangement pays all or part of the premiums, and the party paying the premiums is entitled to recover (either conditionally or unconditionally) all or any portion of those premiums and such recovery is to be made from, or is secured by, the proceeds of the contract.<sup>54</sup> The Tax Court then turned to the issue of whether the shareholders/employees recognized income from their participation in the arrangement.<sup>55</sup> In determining the income tax treatment of split-dollar life insurance arrangements, *i.e.*, whether an income has been recognized, courts determine which of the two Treasury Regulation provisions apply: the economic benefit provisions or loan provisions.<sup>56</sup> The Tax Court found that the economic benefit provisions would apply, and thus, the value, per taxable year, of the economic benefits to a nonowner, *i.e.*, the shareholders/employees, equals:

the sum of (1) the cost of current life insurance protection that the nonowner [individual employee] receives during the year; (2) the amount of the insurance policy cash value to which the nonowner has current access during the year ... ; and (3) any other economic benefit provided to the nonowner (to the extent not previously included in income).<sup>57</sup>

The taxpayers argued that none of the employees (individuals) received an “economic benefit” since they did not have a current or future right to the cash value of the life insurance policies by either direct receipt of cash or by causing the cash to be used to pay other benefits provided under the plan, such as medical or disability benefits, nor could they have caused the policies to be distributed to them.<sup>58</sup> However, the Tax Court disagreed with the taxpayers’ position and found that since the individuals did not make the premium payments on the insurance contracts and the corporate employers were the owners of the contracts, the employees received an economic benefit, which is includable in gross income, in the value of the death benefit for the life insurance contract minus the amount payable to the corporate employer

52 *Our Country Home Enters., Inc. v. Comm’r*, 145 T.C. 1 (2015). According to the Tax Court, these seven cases were selected as “test cases for issues relating to the Sterling [Benefit] Plan” and the parties in approximately 40 other cases pending before the Tax Court “have agreed to be bound by one or more of the decisions in these cases.” *Our Country Home Enters., Inc. v. Comm’r*, 145 T.C. No. 1 (2015). The petitioners of the cases are split into three groups: (1) Our Country Home Enterprises, Inc., which consists of two petitioners, Mr. Blake and his wholly owned C corporation, Our Country Home Enterprises; (2) Netversity, Inc., which also consists of two petitioners, Mr. Mejia and his wholly owned C corporation, Netversity; and (3) Code Environmental Services, Inc., which consists of three petitioners, Mr. Abramo, Mr. Brown, and Mr. Tomassetti, all of which are equal owners of the S corporation Code Environmental Services, Inc. *Our Country Home Enters., Inc. v. Comm’r*, 145 T.C. 1 (2015).

53 *Our Country Home Enters., Inc. v. Comm’r*, 145 T.C. 1 (2015).

54 Treas. Reg. §§ 1.61-22(b)(1); 1.7872-15.

55 The Tax Court also decided if the corporate employers could deduct the payments to the Sterling Benefit Plan and if the petitioners were subject to an accuracy-related penalty.

56 The economic benefit provisions are described in Treas. Reg. § 1.61-22(d)-(g). The loan provisions are described in Treas. Reg. § 1.7872-15.

57 *Our Country Home Enters., Inc. v. Comm’r*, 145 T.C. 1 (2015) (citing Treas. Reg. § 1.61-22(d)(2)).

58 See Treas. Reg. § 1.61-22(d)(4)(ii) (providing that nonowners are treated as having current access to the portion of the insurance policy’s cash value (1) to which the arrangement gives the employee a current or future right, and (2) that is directly or indirectly currently accessible by the employee, inaccessible by the employer, or inaccessible by the employer’s general creditors).

plus the portion of the cash value taxable to (or paid for by) the employee. For the final set of taxpayers, Netversity and Mr. Mejia, the payments made towards the Sterling Benefit Plan, which had not yet purchased a death benefit insurance plan, were “conferred [as] an economic benefit on Mr. Mejia for his primary (if not sole) benefit.”<sup>59</sup> Thus, the payment was a “constructive distribution,” which must be included in gross income as a taxable dividend under IRC § 301(c)(1). Although this case is specific to one purported welfare benefit plan and was a “test” case, it demonstrates the continuation of litigation involving “economic benefits” and split-dollar life insurance arrangements in general.

## CONCLUSION

Taxpayers litigate many of the same gross income issues every year due to the complex nature of what constitutes gross income. As the definition is very broad and the courts broadly interpret accession to wealth as gross income, the IRS prevailed in full in 73 of 81 cases, and courts continued to narrowly interpret exclusions from gross income.

While the number of cases involving the tax treatment of settlements and awards has fluctuated in past years, it continues to be a steady and perennial area of confusion for taxpayers. The National Taxpayer Advocate has previously recommended a legislative change that would clarify the tax treatment of court awards and settlements by permitting taxpayers to exclude any payments received as a settlement or judgment for mental anguish, emotional distress, or pain and suffering.<sup>60</sup>

59 The court also determined that these payments were not deductible as an ordinary and necessary business expense under IRC § 162(a). See Most Litigated Issue: *Trade and Business Expenses*, *supra*, for a discussion on what constitutes “ordinary and necessary” business expenses.

60 National Taxpayer Advocate Annual 2009 Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*).



MLI  
#5

## Trade or Business Expenses Under IRC § 162 and Related Sections

## SUMMARY

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues (MLIs) since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998.<sup>1</sup> We identified 73 cases involving a trade or business expense issue that were litigated in federal courts between June 1, 2015 and May 31, 2016. The courts affirmed the IRS position in 50 of these cases, or about 68 percent, while taxpayers fully prevailed in only five cases, or about seven percent of the cases. The remaining 18 cases, or about 25 percent, resulted in split decisions.

TAXPAYER RIGHTS IMPACTED<sup>2</sup>

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*

## PRESENT LAW

Internal Revenue Code (IRC) § 162(a) permits a taxpayer to deduct ordinary and necessary trade or business expenses paid or incurred during the taxable year.<sup>3</sup> These expenses include:

- Reasonable allowance for salaries or other compensation for personal services actually rendered;
- Travel expenses while away from home in the pursuit of a trade or business; and
- Rentals or other payments for use of property in a trade or business.<sup>4</sup>

In addition to the general allowable expenses described above, IRC § 162 addresses deductible and nondeductible expenses incurred in carrying on a trade or business, and special rules for health insurance costs of self-employed individuals.<sup>5</sup>

The interaction of IRC § 162 with other code sections that explicitly limit or disallow deductions can become very complex. For example, the year in which the deduction for trade or business expenses can be taken depends on when the cost was paid or incurred, the useful life of an asset on the date when it is sold, or when the business operation is terminated.<sup>6</sup>

<sup>1</sup> See National Taxpayer Advocate 1998-2015 Annual Reports to Congress.

<sup>2</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a), 129 Stat. 2242, 3117 (2015) (codified at IRC § 7803(a)(3)).

<sup>3</sup> The taxable year in which a business expense may be deducted depends on whether the taxpayer uses the cash or accrual method of accounting. IRC § 446.

<sup>4</sup> IRC § 162(a)(1), (2), and (3).

<sup>5</sup> See, e.g., IRC § 162(c), (f), and (l). For example, illegal bribes, kickbacks, fines, and penalties are nondeductible payments.

<sup>6</sup> See, e.g., IRC § 165 (deductibility of losses), IRC § 167 (deductibility of depreciation), and IRC § 183 (activities not engaged in for profit).

Rules regarding the practical application of IRC § 162 have evolved largely from case law and administrative guidance over the years. The IRS, the Department of Treasury, Congress and the courts continue to pose questions and provide legal guidance about whether a taxpayer is entitled to certain trade or business deductions. The litigated cases analyzed for this report illustrate that this process is ongoing and involves the analysis of facts and circumstances unique to each case. When a taxpayer seeks judicial review of the IRS's determination of a tax liability relating to the deductibility of a particular expense, the courts must often address a series of questions, including but not limited to, the ones discussed below.

### What Is a Trade or Business Expense Under IRC § 162?

Although “trade or business” is a widely used term in the IRC, neither the Code nor the Treasury Regulations provide a definition.<sup>7</sup> The definition of a “trade or business” comes from common law, where the concepts have been developed and refined by the courts.<sup>8</sup> The Supreme Court has interpreted “trade or business” for purposes of IRC § 162 to mean an activity conducted with “continuity and regularity” and with the primary purpose of earning income or making a profit.<sup>9</sup>

### What Is an Ordinary and Necessary Expense?

IRC § 162(a) requires a trade or business expense to be both “ordinary” and “necessary” in relation to the taxpayer's trade or business to be deductible. In *Welch v. Helvering*, the Supreme Court stated that the words “ordinary” and “necessary” have different meanings, both of which must be satisfied for the taxpayer to benefit from the deduction.<sup>10</sup> The Supreme Court describes an “ordinary” expense as customary or usual and of common or frequent occurrence in the taxpayer's trade or business.<sup>11</sup> The Court describes a “necessary” expense as one that is appropriate and helpful for the development of the business.<sup>12</sup>

Common law also requires that in addition to being ordinary and necessary, the amount of the expense must be reasonable for the expense to be deductible. In *Commissioner v. Lincoln Electric Co.*, the Court of Appeals for the Sixth Circuit held “the element of reasonableness is inherent in the phrase ‘ordinary and necessary.’ Clearly it was not the intention of Congress to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount.”<sup>13</sup>

### Is the Expense a Currently Deductible Expense or a Capital Expenditure?

A currently deductible expense is an ordinary and necessary expense paid or incurred during the taxable year in the course of carrying on a trade or business.<sup>14</sup> No current deductions are allowed for the cost of

<sup>7</sup> *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987). “The phrase ‘trade or business’ has been in section 162(a) and that section's predecessors for many years. Indeed, the phrase is common in the Code, for it appears in over 50 sections and 800 subsections and in hundreds of places in proposed and final income tax regulations... The concept thus has a well-known and almost constant presence on our tax-law terrain. Despite this, the Code has never contained a definition of the words “trade or business” for general application, and no regulation has been issued expounding its meaning for all purposes. Nether has a broadly applicable authoritative judicial definition emerged.”

<sup>8</sup> Carol Duane Olson, *Toward a Neutral Definition of “Trade or Business” in the Internal Revenue Code*, 54 U. CIN. L. REV. 1199 (1986).

<sup>9</sup> *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

<sup>10</sup> 290 U.S. 111, 115 (1933) (suggesting an examination of “life in all its fullness” will provide an answer to the issue of whether an expense is ordinary and necessary).

<sup>11</sup> *Deputy v. du Pont*, 308 U.S. 488, 495 (1940) (citation omitted).

<sup>12</sup> See *Comm'r v. Heining*, 320 U.S. 467, 471 (1943).

<sup>13</sup> 176 F.2d 815, 817 (6th Cir. 1949), *cert. denied*, 338 U.S. 949 (1950).

<sup>14</sup> IRC § 162(a).

acquisition, construction, improvement, or restoration of an asset expected to last more than one year.<sup>15</sup> Instead, those types of expenses are generally considered capital expenditures, which may be subject to depreciation, amortization, or depletion over the useful life of the property.<sup>16</sup>

Whether an expenditure is deductible under IRC § 162(a) or is a capital expenditure under IRC § 263 is a question of fact. Courts have adopted a case-by-case approach to applying principles of capitalization and deductibility.<sup>17</sup>

### When Is an Expense Paid or Incurred During the Taxable Year, and What Proof Is There That the Expense Was Paid?

IRC § 162(a) requires an expense to be “paid or incurred during the taxable year” to be deductible. The IRC also requires taxpayers to maintain books and records that substantiate income, deductions, and credits, including adequate records to substantiate deductions claimed as trade or business expenses.<sup>18</sup> If a taxpayer cannot substantiate the exact amounts of deductions by documentary evidence (*e.g.*, invoice paid, paid bill, or canceled check) but can establish that he or she had some business expenditures, the courts may employ the *Cohan* rule to grant the taxpayer a reasonable amount of deductions.

#### The Cohan Rule

The *Cohan* rule is one of “indulgence” established in 1930 by the Court of Appeals for the Second Circuit in *Cohan v. Commissioner*.<sup>19</sup> The court held that the taxpayer’s business expense deductions were not adequately substantiated, but stated that “the [Tax Court] should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent.”<sup>20</sup> In *Estate of Elkins v. Commissioner*, the Fifth Circuit recently described “the venerable lesson of Judge Learned Hand’s opinion in *Cohan*: In essence, make as close an approximation as you can, but never use a zero.”<sup>21</sup>

15 IRC § 263. See also *INDOPCO, Inc. v. Comm’r*, 503 U.S. 79 (1992).

16 IRC § 167.

17 See *PNC Bancorp, Inc. v. Comm’r*, 212 F.3d 822 (3d Cir. 2000); *Norwest Corp. v. Comm’r*, 108 T.C. 265 (1997).

18 IRC § 6001. See also Treas. Reg. §§ 1.6001-1 and 1.446-1(a)(4).

19 39 F.2d 540 (2d Cir. 1930). George M. Cohan was an actor, playwright, and producer who spent large sums travelling and entertaining actors, employees, and critics. Although Cohan did not keep a record of his spending on travel and entertainment, he estimated that he incurred \$55,000 in expenses over several years. The Board of Tax Appeals, now the Tax Court, disallowed these deductions in full based on Cohan’s lack of supporting documentation. Nevertheless, on appeal, the Second Circuit concluded that Cohan’s testimony established that legitimate deductible expenses had been incurred. As a result, the Second Circuit remanded the case back to the Board of Tax Appeals with instructions to estimate the amount of deductible expenses.

20 39 F.2d 540 (2d Cir. 1930) at 544, *aff’g and remanding* 11 B.T.A. 743 (1928).

21 767 F.3d 443, 449 n. 7 (5th Cir. 2014) (citing *Cohan*, 39 F.2d at 543-44), *rev’g* 140 T.C. 86 (2013).

The *Cohan* rule cannot be used in situations where IRC § 274(d) applies. IRC § 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deductions are allowable for:

- Travel expenses;
- Entertainment, amusement, or recreation expenses;
- Gifts; and
- Certain “listed property.”<sup>22</sup>

A taxpayer must substantiate a claimed IRC § 274(d) expense with adequate records or sufficient evidence to establish the amount, time, place, and business purpose.<sup>23</sup> A contemporaneous log is not explicitly required, but a statement not made at or near the time of the expenditure has the same degree of credibility only if the corroborative evidence has “a high degree of probative value.”<sup>24</sup> In addition, entertainment expenses require proof of a business relationship to the taxpayer.<sup>25</sup>

### Who Has the Burden of Proof in a Substantiation Case?

Generally, the taxpayer bears the burden of proving that he or she is entitled to the business expense deductions and the IRS’s proposed determination of tax liability is incorrect.<sup>26</sup> IRC § 7491(a) provides that the burden of proof shifts to the IRS when the taxpayer:

- Introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer’s liability;
- Complies with the requirements to substantiate deductions;
- Maintains all records required under the Code; and
- Cooperates with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews.

## ANALYSIS OF LITIGATED CASES

The deductibility of trade or business expenses has been one of the ten MLIs since the first edition of the National Taxpayer Advocate’s Annual Report to Congress in 1998.<sup>27</sup> This year, we reviewed 73 cases involving trade or business expenses that were litigated in federal courts from June 1, 2015 through May 31, 2016. Table 5 listed in Appendix 3 contains a list of the main issues in these cases. Figure 3.5.1 categorizes the main issues raised by taxpayers. Cases involving more than one issue are included in more than one category.

22 “Listed property” means any passenger automobile; any other property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; any computer or peripheral equipment (except when used exclusively at a regular business establishment and owned or leased by the person operating such establishment); and any other property specified by regulations. IRC §§ 280F(d)(4)(A) and (B).

23 Treas. Reg. § 1.274-5T(b).

24 Treas. Reg. § 1.274-5T(c)(1); *Reynolds v. Comm’r*, 296 F.3d 607, 615-16 (7th Cir. 2002) (noting that keeping written records is not the only method to substantiate IRC § 274 expenses but “alternative methods are disfavored”).

25 Treas. Reg. § 1.274-5T(b)(3)(v).

26 See *Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted) and U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

27 See National Taxpayer Advocate 1998-2015 Annual Reports to Congress.

**FIGURE 3.5.1, Trade or Business Expense Issues Cases Reviewed<sup>28</sup>**

| Issue  | Type of Taxpayer |          |
|--|------------------|----------|
|  | Individual       | Business |
| Substantiation of Expenses, Including Application of the <i>Cohan</i> Rule | 5                | 31       |
| Substantiation of Expenses Under IRC § 274(d)                              | 3                | 22       |
| Ordinary and Necessary Trade or Business Expenses                          | 0                | 13       |
| Not a Qualifying Trade or Business Carried on for Profit                   | 1                | 16       |
| Home Office  | 0                | 10       |

Taxpayers represented themselves (*pro se*) in 45 of the 73 cases (about 62 percent). Taxpayers were represented by counsel in 28 out of the 73 cases (about 38 percent). Of the 73 cases, the taxpayers prevailed in five cases in full, and in 18 cases in part. The IRS won in the remaining 50 cases, none of the *pro se* individual taxpayers prevailed.

As in previous years, individual taxpayers routinely claimed deductions for vehicle and transportation expenses without understanding, or knowledge of, the substantiation requirements under IRC § 274(d). Many *pro se* litigants were unable to meet the strict substantiation requirements.<sup>29</sup>

### Individual Taxpayers

None of the decisions involving individual taxpayers (where the term “individual” excludes a sole proprietorship) were issued as a regular opinion of the Tax Court.<sup>30</sup> All of the individual taxpayers appeared *pro se*. The court fully upheld the IRS in all of the cases.

The most common issue before the court was the substantiation of claimed business deductions.<sup>31</sup> For example, in *Garcia v. Commissioner*, the husband was a truck driver who incurred expenses for meals and lodging while on the road for work.<sup>32</sup> The married couple claimed deductions for token gifts he had given to workers who helped him to unload his truck, clothing and boots used for his job, and cell phone expenditures.<sup>33</sup> The taxpayer produced cancelled checks, credit card bills, and bank account statements to substantiate these expenses. However, the taxpayer did not maintain a contemporaneous record of the amount, timing, or business nature of the alleged unreimbursed employee business expenses as required under IRC § 274(d). The Tax Court disallowed these deductions because the taxpayer failed to

28 Multiple issues can appear within one case; therefore these figures will not match the total case count.

29 See *Avery v. Comm’r*, T.C. Memo. 2016-50 (denying deductions for vehicle and travel expenses).

30 Tax Court decisions are categorized into three types: regular decisions, memorandum decisions, and small tax case (“S”) decisions. The regular decisions of the Tax Court include cases which have some new or novel point of law, or in which there may not be general agreement, and therefore have the most legal significance. In contrast, memorandum decisions generally involve fact patterns within previously settled legal principles and therefore are not as legally significant. Finally, “S” case decisions (for disputes involving \$50,000 or less where the taxpayer has elected Small Case status) are not appealable and, thus have no precedential value. See IRC § 7463(b). See also U.S. Tax Court Rules of Practice and Procedure, Rules 170-175.

31 See, e.g., *Akey v. Comm’r*, T.C. Memo. 2015-227; *Garcia v. Comm’r*, T.C. Memo. 2016-21.

32 T.C. Memo. 2016-21.

33 The taxpayer stated that the cell phone was required by the employer and that he used it solely for business purposes which the court did not find credible.

maintain adequate records and because the costs of clothing the husband purchased was not specific to his employment.<sup>34</sup>

### Business Taxpayers

We reviewed 63 cases involving business taxpayers. Business taxpayers had a much better success rate compared to individual taxpayers. As stated above, individual taxpayers did not prevail in any cases. Meanwhile, business taxpayers received full or partial relief in 37 percent of cases (23 out of 63 cases).

Business taxpayers were represented by counsel in 35 percent (8 of 23) of favorably decided cases, including four cases where the taxpayer received full relief. Business taxpayers were represented by counsel in 40 percent (20 of 50) of the cases that the IRS won. To the extent that *pro se* taxpayers were successful in court, these favorable outcomes stemmed mostly from their ability to provide records substantiating deductions in cases where such substantiation was in controversy. Courts did, however, allow some of these deductions where the taxpayer produced sufficient evidence.<sup>35</sup>

As was the case for the individual taxpayers, substantiation of expenses was by far the most prevalent issue, and in most instances, the courts denied the business taxpayers' deductions for failure to substantiate.<sup>36</sup> The courts allowed deductions for some expenses when business taxpayers were able to provide sufficient evidence in the form of records, receipts, or logs.<sup>37</sup> Courts occasionally applied the *Cohan* rule where the taxpayer presented sufficient documentation to prove an expense was incurred but had limited documentation of the precise amount.<sup>38</sup> As previously mentioned, however, IRC § 274(d) makes the *Cohan* rule unavailable in certain circumstances in which the taxpayer must substantiate the deductions.

Taxpayers were also denied business expense deductions under IRC § 262(a) when the courts found the expenses were related to personal rather than business activities. In *Jijun Chen v. Commissioner*, the taxpayer was the owner of a biotechnology company.<sup>39</sup> The taxpayer provided a self-created spreadsheet to substantiate several Schedule C expenses. This spreadsheet contained dates, names of vendors/items, and amounts paid. The vendors listed were department stores, salons, music stores, and other common stores. The taxpayer failed to establish how the expenses incurred at these stores were done so by the biotechnology company in carrying on its trade or business. In fact, most of these business expense deductions were indeed personal in nature and were for the benefit of the taxpayer's children. The taxpayer's expenses related to an employee benefits program that consisted entirely for sending his children to daycare. The travel and entertainment expenses and depreciation of musical instruments were also related to the education of the taxpayer's children. The court could not find any relationship between these deductions and the ordinary and necessary needs of a biotechnology company. These expenses were personal in nature and thus disallowed.

34 Clothing costs may be deductible if the clothing is a type specifically required as a condition of employment, it is not suitable for wear as ordinary clothing, and it is not worn as ordinary clothing. *Pevsner v. Comm'r*, 628 F.2d 467, 469 (5th Cir. 1980) (citation omitted).

35 See, e.g., *Charley v. Comm'r*, T.C. Memo. 2015-232.

36 See *Philbrick v. Comm'r*, T.C. Memo. 2016-64; *Porter v. Comm'r*, T.C. Memo. 2015-122.

37 See *Charley v. Comm'r*, T.C. Memo. 2015-232 (business mileage expenses substantiated through index cards and credible testimony).

38 See *Arizaga v. Comm'r*, T.C. Memo. 2016-57.

39 T.C. Memo. 2015-167.



Courts likewise generally sustained IRS determinations that business expense deductions were not attributable to an activity engaged in for profit within the meaning of IRC § 183.<sup>40</sup> However, in *Roberts v. Commissioner*, the taxpayer successfully established that he was engaged in the business of horse-racing.<sup>41</sup> To arrive at this conclusion, the Tax Court proceeded to examine the taxpayer's deductions using the nine-factor test of Treas. Reg. § 1.183-2(b).<sup>42</sup> Not a single one of the nine factors is determinative nor are they the only factors that can be taken into account when making a determination of whether a taxpayer's activities are engaged in for profit. The Tax Court decided that Mr. Roberts's horse-racing business was run as a hobby rather than a business and thus disallowed the expenses above the hobby profits. Upon appeal, the Court of Appeals for the Seventh Circuit reversed the Tax Court due to evidence that supported that business nature of the horse-racing conducted by Mr. Roberts. The evidence in support of the business nature of the horse-racing included the fact that the taxpayer purchased land specifically for expanding his ability to breed, race, and train horses. He became certified as a licensed trainer by the state and obtained his horse-racing license. He worked long hours with the horses and ceased his involvement with his previous businesses. One of the horses in his care was nominated to run in the Triple Crown Races which had the potential to greatly increase the profits to his horse-racing business. In fact, the Seventh Circuit was able to find support for all nine factors that Mr. Roberts conducted the horse-racing activity with the hopes of turning a profit. The fact that the activity had a social aspect and the lack of profit for the years in question were not enough to nullify the business nature of his activities.

Conversely, in *Estate of Stuller v. U.S.*, the Court of Appeals for the Seventh Circuit found that the manner in which the taxpayer conducted the activity of horse-breeding was not engaged in a manner consistent with a profit motive.<sup>43</sup> The court applied the nine factor test and found that only one, the expectation of asset appreciation, supported the taxpayer's assertion that the horse-breeding was carried on for profit. The evidence showed that the taxpayer kept minimal business records and did not retain any records of expenses related to the activities of horse-breeding. The lack of records kept essentially made it impossible for the taxpayer to make sound business decisions. The taxpayer did not change the operation methods or try new techniques to improve profitability. Nor did the taxpayer consult with any experts in the industry to determine better methods for running a horse-breeding endeavor. The taxpayer was able to rely upon the earnings from other businesses rather than relying upon horse-breeding which is also indicative that the activity was not carried out with a profit motive. The taxpayer derived great pleasure from the horse-breeding operation so the significant amount of time spent engaged in the activity is not necessarily a factor weighing in the taxpayer's favor. Unlike in *Roberts v. Commissioner*, the court was unable to determine that the horse-breeding activities conducted by Mr. Stuller were for profit and thus disallowed the deductions.

Another frequently litigated area was related to deductions taken in support of home offices. Taxpayers also had difficulty validating their home office deductions, losing in cases where business use of a home

40 See, e.g., *Stuller, Estate of, v. U.S.*, 811 F.3d 890 (7th Cir. 2016) (corporation was not an activity run for profit, had poor recordkeeping, lacked business practices directed at making a profit); *Pouemi v. Comm'r*, T.C. Memo. 2015-161, *aff'd*, 633 F. App'x 186 (4th Cir. 2016) (real estate activity not conducted in a businesslike manner, lacked a business plan, did not maintain a business bank account, and did not keep business books or records).

41 820 F.3d 247 (7th Cir. 2016), *rev'g* T.C. Memo. 2014-74.

42 Those factors are: (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

43 811 F.3d 890 (7th Cir. 2016).

residence was in question.<sup>44</sup> For instance, in *Grossnickle v. Commissioner*, the taxpayer, a real estate agent, sought to claim a home office expense for a room she rented from a family member.<sup>45</sup> The taxpayer failed to show any rents paid or other substantiation that she used the space exclusively as her principal place of business. Thus, the Tax Court denied the home office expenses.

## CONCLUSION

The existence and amount of allowable business expenses are highly fact-specific and are often open to interpretation. This circumstance continues to generate substantial controversy between the IRS and taxpayers regarding the scope and extent of properly claimed business deductions. This year, as in prior years, the IRS actively scrutinized and challenged many such deductions, while taxpayers were often willing to resort to litigation where the disallowance could not be administratively resolved within the IRS. The courts generally favored the IRS's denial of business expense deductions, but specific facts and circumstances yielded some victories for taxpayers.

The *Cohan* rule was also a factor in several decisions this year. This common law doctrine allows taxpayers to deduct estimated expenses in cases where the expenses clearly existed but documentation showing the exact amount of the expenses is not readily available. The National Taxpayer Advocate believes the IRS Office of Appeals should expand the use of the *Cohan* rule in assessing hazards of litigation and in seeking to reach settlements with taxpayers.<sup>46</sup> The Examination process that often leads to Appeals, however, does not employ the *Cohan* rule and has adopted a more stringent document request policy to close cases and bypass Appeals in several instances.<sup>47</sup>

Through education, outreach, and partnering with stakeholders, the IRS can help taxpayers understand what trade or business deductions are allowable and how they must substantiate those expenses. The IRS should continue to reach out proactively to taxpayers about these issues.

Proactive education and outreach to taxpayers regarding trade or business expenses will likewise promote taxpayers' *rights to be informed and to challenge the IRS's position and be heard*. By helping taxpayers understand not only the legal requirements but also their rights, the IRS will encourage taxpayers to comply with their tax obligations and minimize the risk of litigation.

<sup>44</sup> See *Hawk v. Comm'r*, T.C. Memo. 2015-139 (denying expenses related to the home office). See also *Jijun Chen v. Comm'r*, T.C. Memo. 2015-167.

<sup>45</sup> T.C. Memo. 2015-127.

<sup>46</sup> See National Taxpayer Advocate 2015 Annual Report to Congress (Most Serious Problem: Appeals: *The Appeals Judicial Approach and Culture Project is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers*).

<sup>47</sup> *Id.*

MLI  
#6**Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654****SUMMARY**

We reviewed 45 decisions issued by federal courts from June 1, 2015, to May 31, 2016, regarding the additions to tax for:

- Failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1);
- Failure to pay an amount shown on a tax return under IRC § 6651(a)(2);
- Failure to pay an amount shown on a tax return within 21 days of the issuance of a notice and demand under IRC § 6651(a)(3);
- Failure to pay installments of the estimated tax under IRC § 6654; or
- Some combination of the four.<sup>1</sup>

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Eight cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; four cases involved the estimated tax penalty and either the failure to file penalty or the failure to pay penalty under IRC §§ 6651(a)(2) or (a)(3); 32 involved the failure to file or failure to pay penalties; one case involved only the estimated tax penalty.

The IRS imposes the failure to file and failure to pay penalties unless the taxpayer can demonstrate the failure is due to reasonable cause and not willful neglect.<sup>2</sup> The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions.<sup>3</sup> Taxpayers were unable to avoid a penalty in 41 of the 45 cases.

**TAXPAYER RIGHTS IMPACTED<sup>4</sup>**

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

<sup>1</sup> For the first time in the Most Litigated Issue on the failure to file, failure to pay, and failure to pay installments of estimated tax, we have included cases where a decision was made on penalties imposed under Internal Revenue Code (IRC) § 6651(a)(3) failure to pay amount due within 21 days of the issuance of a notice and demand.

<sup>2</sup> IRC §§ 6651(a)(1), (a)(2).

<sup>3</sup> IRC § 6654(e).

<sup>4</sup> See Taxpayer Bill of Rights (TBOR), <https://taxpayeradvocate.irs.gov/taxpayer-rights>. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a), 129 Stat. 2242, 3117 (2015) (codified at IRC § 7803(a)(3)).

## PRESENT LAW

Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before the due date (including extensions) will be subject to a failure to file penalty of five percent of the tax due (minus any credit the taxpayer is entitled to receive and payments made by the due date) for each month or partial month the return is late. This penalty will accrue up to a maximum of 25 percent, unless the failure is due to reasonable cause and not willful neglect.<sup>5</sup> To establish reasonable cause, the taxpayer must show the exercise of ordinary business care and prudence but the taxpayer was still unable to file by the due date.<sup>6</sup> The failure to file penalty applies to income, estate, gift, employment, self-employment, and certain excise tax returns.<sup>7</sup>

The failure to pay penalties, IRC §§ 6651(a)(2) and (a)(3), apply to a taxpayer who fails to pay an amount shown as tax on the return. The penalty accrues at a rate of 0.5 percent per month on the unpaid balance for as long as it remains unpaid, up to a maximum of 25 percent of the amount due.<sup>8</sup> When IRS imposes both the failure to file and failure to pay penalties for the same month, it reduces the failure to file penalty by the amount of the failure to pay penalty (0.5 percent for each month).<sup>9</sup>

The failure to pay penalty applies to income, estate, gift, employment, self-employment, and certain excise tax returns.<sup>10</sup> The taxpayer will not be held liable if the taxpayer can establish reasonable cause, *i.e.*, the taxpayer must show the exercise of ordinary business care and prudence but was still unable to pay by the due date, or that payment on that date would have caused undue hardship.<sup>11</sup> Courts will consider “all the facts and circumstances of the taxpayer’s financial situation” to determine whether the taxpayer exercised ordinary business care and prudence.<sup>12</sup> In addition, “consideration will be given to the nature of the tax which the taxpayer has failed to pay.”<sup>13</sup> Failure to pay a deficiency within 21 calendar days from the date a notice and demand is issued (or ten business days if the amount exceeds \$100,000) may result in a penalty under IRC § 6651(a)(3). In general, the addition to tax is 0.5 percent of the tax not paid, for each month or part of a month that the tax remains unpaid, up to a maximum of 25 percent.<sup>14</sup> As in IRC §§ 6651(a)(1) and (a)(2) discussed above, the taxpayer will not be liable for the penalty if failure to pay is due to reasonable cause and not to willful neglect.<sup>15</sup>

IRC § 6654 imposes a penalty on any underpayment of estimated tax by an individual or by certain estates or trusts.<sup>16</sup> The law requires four installments per tax year, each generally 25 percent of the

5 IRC §§ 6651(a)(1), (b)(1). The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

6 Treas. Reg. § 301.6651-1(c)(1).

7 IRC § 6651(a)(1).

8 IRC § 6651(a)(2). Note that if the taxpayer timely files the tax return (including extensions) but an installment agreement is in place, the penalty will continue accruing at the lower rate of 0.25 percent rather than 0.5 percent of the tax shown. IRC § 6651(h).

9 IRC § 6651(c)(1). When both the failure to file and failure to pay penalties are accruing simultaneously, the failure to file will max out at 22.5 percent and the failure to pay will max out at 2.5 percent, thereby abiding by the 25 percent maximum limitation.

10 IRC § 6651(a)(2).

11 Treas. Reg. § 301.6651-1(c)(1). Even when a taxpayer shows undue hardship, the regulations require proof of the exercise of ordinary business care and prudence.

12 Treas. Reg. § 301.6651-1(c)(1). See, e.g., *East Wind Indus., Inc. v. U.S.*, 196 F.3d 499, 507 (3d Cir. 1999).

13 Treas. Reg. § 301.6651-1(c)(2).

14 IRC § 6651(a)(3).

15 IRC § 6651(a)(3).

16 IRC § 6654(a), (l).

required annual payment.<sup>17</sup> The required annual payment is generally the lesser of 90 percent of the tax shown on the return for the current tax year or 100 percent of the tax for the previous tax year.<sup>18</sup> The IRS will determine the amount of the penalty by applying the underpayment rate, according to IRC § 6621, to the amount of the underpayment for the applicable period.<sup>19</sup>

To avoid the penalty, the taxpayer has the burden of proving that one of the following exceptions applies:

- The tax due (after taking into account any federal income tax withheld) is less than \$1,000;<sup>20</sup>
- The preceding tax year was a full 12 months, the taxpayer had no liability for the preceding tax year, and the taxpayer was a U.S. citizen or resident throughout the preceding tax year;<sup>21</sup>
- The IRS determines that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience;<sup>22</sup> or
- The taxpayer retired after reaching age 62, or became disabled, in the tax year for which estimated payments were required, or in the tax year preceding that year, and the underpayment was due to reasonable cause and not willful neglect.<sup>23</sup>

In any court proceeding, the IRS has the burden of producing sufficient evidence that it imposed the failure to file, failure to pay, or estimated tax penalties appropriately.<sup>24</sup>

## ANALYSIS OF LITIGATED CASES

We analyzed 45 opinions issued between June 1, 2015, and May 31, 2016, where the failure to file penalty, failure to pay penalty, or estimated tax penalty was in dispute. All but eight of these cases were litigated in the United States Tax Court. A detailed list appears in Table 6 in Appendix 3. Twenty-eight cases involved individual taxpayers and 17 involved businesses (including individuals engaged in self-employment or partnerships).

Of the 28 cases in which taxpayers appeared *pro se* (without counsel), taxpayers did not fully prevail in any, and only two cases resulted in split decisions. Of the 17 cases in which taxpayers had representation, taxpayers prevailed in full in one case, and in part in two cases.

### Failure to File Penalty

In most of the cases reviewed, taxpayers could not successfully establish that the failures to file were due to reasonable cause. Circumstances suggesting reasonable cause are typically outside the taxpayer's control.<sup>25</sup> Frequent reasonable cause claims included medical illness and reliance on an agent. In 38 cases reviewed where the failure to file penalty was at issue, the taxpayers could not successfully establish that the failures to file were due to reasonable cause in 32 cases.

17 IRC §§ 6654(c)(1), (d)(1)(A).

18 IRC § 6654(d)(1)(B).

19 IRC § 6654(a).

20 IRC § 6654(e)(1).

21 IRC § 6654(e)(2).

22 IRC § 6654(e)(3)(A).

23 IRC § 6654(e)(3)(B).

24 *Higbee v. Comm'r*, 116 T.C. 438, 446 (2001) (applying IRC § 7491(c)). An exception to this rule relieves the IRS of this burden where the taxpayer's petition fails to state a claim for relief from the penalty (and therefore is deemed to concede the penalty). *Funk v. Comm'r*, 123 T.C. 213, 218 (2004).

25 *McMahan v. Comm'r*, 114 F.3d 366, 369 (2d Cir. 1997) (citation omitted), *aff'g* T.C. Memo.1995-547.

## Medical Illness

Depending on the facts and circumstances, a medical illness may establish reasonable cause for failure to file, if the taxpayer can show incapacitation to such a degree that he or she could not file a tax return on time. When considering whether the severity of the illness suffices to establish reasonable cause, the court will analyze a taxpayer's management of his or her business affairs during the illness.

In *Poppe v. Commissioner*, the taxpayer argued that failure to file his 2007 tax return was due to reasonable cause because he suffered from an autistic spectrum disorder (ASD)<sup>26</sup> previously known as Asperger's Syndrome, which prevented him from filing his tax return timely for tax year (TY) 2007.<sup>27</sup> During the trial, the taxpayer offered the testimony of a licensed psychologist who explained that ASD can impede an individual's executive functions and social cognition and create a high dependency on routines. However, the Tax Court gave this testimony little weight because the individual who offered the testimony was a licensed psychologist and not a medical physician.<sup>28</sup> Further, the licensed psychologist did not treat the taxpayer during the time in which he claimed he was impaired from filing a tax return. In addition, the taxpayer was unable to show how ASD impaired his life in other ways. For instance, the taxpayer was a teacher from 2001 through 2006 and did not provide any documentation showing that he ever requested any accommodation while teaching. While a teacher, the taxpayer was also day-trading two hours per school day. In 2007, he began trading on a full-time basis. When conducting these trades on a full-time basis, the taxpayer had six monitors in his workstation that showed the status of his trades. Further, the taxpayer was able to collect and analyze information on which to base his trades. Despite the taxpayer's ability to function in these situations, he claims that he was unable to file his tax return for TY 2007 because he was distraught over losses he suffered for that year. Although the Tax Court was "sympathetic to [taxpayer's] plight," it was unable to find that the taxpayer's mental condition prevented him from conducting his business affairs.<sup>29</sup> Therefore, the taxpayer's failure to file the 2007 tax return timely was not due to reasonable cause.<sup>30</sup>

26 Centers for Disease Control and Prevention (CDC), *Facts about ASD* (Mar. 2016), <http://www.cdc.gov/ncbddd/autism/facts.html>. ASD is a developmental disability that can cause significant social, communication, and behavioral challenges. Individuals with ASD might not point at objects to show interest, have trouble relating to others or not have an interest in other people at all, avoid eye contact and want to be alone, have trouble understanding other people's feelings or talking about their own feelings, appear to be unaware when people talk to them but respond to other sounds, have trouble expressing their needs using typical words or motions, repeat actions over and over again, have trouble adapting when a routine changes, lose skills they once had (for example, stop saying words they were using), etc.

27 *Poppe v. Comm'r*, T.C. Memo. 2015-205.

28 National Taxpayer Advocate 2013 Annual Report to Congress 302; National Taxpayer Advocate 2015 Annual Report to Congress 368. The National Taxpayer Advocate has previously recommended that the IRS consider letters from other health professionals such as clinical psychologists or social workers, when determining if a taxpayer was unable to file a refund claim required under IRC § 6511(a) due to a mental disability that rendered him or her unable to manage his or her financial affairs, thereby meeting the definition of disability under IRC § 6511(h).

29 The court relied on *Hardin v. Comm'r*, T.C. Memo. 2012-162, even though the taxpayer suffered from attention deficit hyperactivity disorder, posttraumatic stress syndrome, and bipolar disorder; his mental condition did not prevent him from engaging in activities that required a high degree of concentration and ability to analyze and organize information.

30 Due to the resolution of the issues raised in the notice of deficiency, the taxpayer had no tax liability. Consequently, when the stipulated decision was entered, there was no failure to file penalty due from the taxpayer.



### Reliance on Agent

The U.S. Supreme Court, in *United States v. Boyle*, held that taxpayers have a non-delegable duty to file a tax return on time.<sup>31</sup> The Court noted that “[i]t requires no special training or effort to ascertain a deadline and make sure that it is met.”<sup>32</sup> Therefore, a taxpayer’s reliance on an agent to file a tax return does not excuse any failure to comply with a known filing requirement.

In *Redstone v. Commissioner*, the taxpayer conducted a transaction where he transferred stock into trusts that were being held for his children.<sup>33</sup> The taxpayer did not file a gift tax return for these transactions, and the IRS therefore imposed a failure to file penalty. The taxpayer argued that he was not liable for the failure to file penalty because he reasonably relied on the advice of a tax professional. In fact, the tax advisors offered the taxpayer advice about his gift tax filing requirements on 34 occasions beginning in 1970. Further, the evidence showed that the taxpayer relied on a written memorandum that stated no gift tax return was required to be filed because the taxpayer had not made a taxable gift and that the taxpayer relied on this advice in good faith. Therefore, the Tax Court concluded that the taxpayer was not liable for an addition to tax for failure to file a gift tax return.

In *West v. Commissioner*, the estate (hereafter referred to as the taxpayer) failed to file a timely estate tax return.<sup>34</sup> The taxpayer argued that it reasonably relied on the advice of a tax professional. After the death of June West, the executors of her estate, her children — Peter, Lesley, and John, began working with their mother’s attorney, John Rodgers, to settle the estate. On January 3, 2010, Peter West emailed Mr. Rodgers seeking guidance as to “what legal followups are needed in the short term.”<sup>35</sup> Mr. Rodgers responded via email the following day informing Peter West that the estate would need to pay any outstanding bills, possibly file a federal estate tax return, and file her final Form 1040, *U.S. Individual Income Tax Return*, and a trust income tax return. Mr. Rodgers went on to say in his email, “[t]his all takes as short as a few months or (if an estate tax return is required) as long as [two] years.”<sup>36</sup>

The following day, Peter West, again via email, responded that he was “sure there will be tax due” on the estate and that he “assume[d]” that John Renner, the accountant hired to do June West’s 2009 taxes, “would also take care of preparing estate taxes.”

On or about February 1, 2010, the executors of the estate met with Mr. Rodgers in person to discuss issues relating to the estate. During this meeting, the executors of the estate did not inquire about the filing and payment deadlines for the estate tax, nor did Mr. Rodgers volunteer that information. In fact, as Peter West later testified at his deposition, “[Rodgers] only gave the executors of the estate, both in the prior email and during the meeting, a general timeframe of two years for the taxes.” Following this February meeting, the executors of the estate had no further contact with Rodgers until November 2010, at which time the filing deadline for the estate tax return had already passed.

In November 2010, Peter West met with his siblings and thereafter emailed Mr. Rodgers inquiring as to what needed to be done to start work on the estate taxes. Mr. Rodgers interpreted this question as Peter West’s hiring him to prepare the estate tax return, and Mr. Rodgers began work preparing the estate tax return in December 2010. Mr. Rodgers was not concerned that the deadline for filing had already

31 *U.S. v. Boyle*, 469 U.S. 241 (1985).

32 *Id.* at 252.

33 *Redstone v. Comm’r*, T.C. Memo. 2015-237.

34 *West v. Comm’r*, 141 F.Supp. 3d 498 (E.D. Va. 2015).

35 *Id.* at 499.

36 *Id.*

passed, and he never mentioned this fact to the executors, as he mistakenly assumed that Mr. Renner, the accountant, had obtained the appropriate extension, as Peter West had earlier advised Mr. Rodgers that Mr. Renner would “take care of preparing estate taxes.”

In March 2011, Lesley West filed the tax return and paid the associated taxes. Shortly after filing the tax return, Lesley received a notice indicating the taxpayer owed the failure to file penalty. In June 2011, Mr. Rodgers filed a request with the IRS to abate these penalties on the basis of reasonable cause. The request was denied, and the taxpayer paid the penalties. Mr. Rodgers subsequently filed a claim for refund on behalf of the estate.

The taxpayer subsequently filed a refund suit, claiming that the failure to file penalty should be abated on the basis of reasonable cause for reliance on Mr. Rodgers’ legal advice, and that the penalty paid by the taxpayer should thereby be refunded.

The taxpayer argued that it had reasonable cause for failing to file the tax return because it had reasonably relied on Mr. Rodgers’ statement that “[t]his all takes as short as a few months or ... as long as [two] years.” The taxpayer interpreted this statement as saying it had up to two years to file the tax return. However, the court determined that this email from Mr. Rodgers was not legal advice as to the estate tax return filing deadline. The court then concluded that no reasonable person exercising ordinary business care and prudence would rely on the email for that purpose; rather, a reasonable person would have sought clarification, which the executors might have done during the face-to-face meeting with Mr. Rodgers in February. Furthermore, the court pointed out that the executors had ample opportunity to seek clarity as to the deadline but chose instead to construe vague language as specifying a “two-year” filing deadline. The court concluded that Rodgers never offered any legal advice as to the filing deadline and thus held that the taxpayer’s claim of reasonable cause based on reliance on the erroneous advice of counsel fails because the taxpayer never actually received advice from Mr. Rodgers as to an estate tax return filing deadline.<sup>37</sup>

### Failure to Pay an Amount Shown Penalty

A taxpayer can file a tax return by the due date and still be liable for a penalty under IRC § 6651(a)(2) if the amount shown on the tax return is not timely paid. Further, under IRC § 6651(a)(3), a penalty may apply if a taxpayer fails to pay a deficiency within 21 calendar days from the date a notice and demand is issued (or ten business days if the amount exceeds \$100,000). As described above, to assert a reasonable cause defense for purposes of the failure to pay penalty, the taxpayer must show that he or she exercised ordinary business care and prudence in providing for payment of tax liabilities but nevertheless was either unable to timely pay the tax or would suffer undue hardship if the payment was made on time.<sup>38</sup> In cases where individual taxpayers disputed that they were subject to the failure to pay penalty, many of their arguments for reasonable cause were similar to those used for the failure to file penalty under IRC § 6651(a)(1). The taxpayers often unsuccessfully argued medical illness or reliance on an agent or failed to make a separate and distinct argument relevant to the failure to pay.<sup>39</sup>

However, a taxpayer can prevail on the failure to pay penalty when the IRS cannot meet its burden of production under IRC § 7491(c). Specifically, the IRC §§ 6651(a)(2) or (a)(3) penalties apply only when

<sup>37</sup> West, 141 F.Supp.3d at 503. See also Treas. Reg. § 301.6651-1(c)(1).

<sup>38</sup> See Treas. Reg. § 301.6651-1(c)(1).

<sup>39</sup> See, e.g., *Akey v. Comm’r*, T.C. Memo. 2015-227 (illness and break-in did not establish reasonable cause); *Poppe*, T.C. Memo. 2015-205 (mental condition did not establish reasonable cause); and West, 141 F. Supp. 3d at 498 (reliance on tax professional did not establish reasonable cause).

the taxpayer's *filed* tax return shows an amount due.<sup>40</sup> If the taxpayer did not file a tax return, the IRS can only assess the penalties if it has introduced a Substitute for Return (SFR) that satisfies the requirements of IRC § 6020(b). If the IRS cannot produce the SFR, it fails to meet its burden of production under IRC § 7491.<sup>41</sup>

In *Nutrition Formulators, Inc. v. Commissioner*, the taxpayer petitioned the Tax Court to reconsider the IRS Settlement Officer's determination in a Collection Due Process hearing that the failure to pay penalty for unpaid employment taxes for tax periods ending June 30, September 30, and December 31, 2011, and March 31, 2012, should not be abated for reasonable cause.<sup>42</sup> The taxpayer argued that the company was a victim of embezzlement perpetrated by their former accountant and that the embezzlement exceeded the amount its former Certified Public Accountant was to pay in restitution. In addition, the taxpayer argued that it was impaired from paying its taxes due to the expenses it incurred for relocating its manufacturing operations to comply with Food and Drug Administration (FDA) regulations. However, the taxpayer was unable to show that the embezzlement impaired its ability to pay its taxes. Further, it could not show that the FDA regulations required its manufacturing operation to relocate, or that the debt incurred as a result of this relocation impaired its ability to timely pay taxes. Therefore, the Tax Court held that the taxpayer did not have reasonable cause for failure to timely pay its taxes.

In *Ibarra v. Commissioner*, the taxpayer was assessed a failure to pay penalty for TY 2010.<sup>43</sup> The taxpayer argued that he was unable to pay his tax liability due to the fact that he lost his job earlier in the year and incurred large expenses for treatment of his wife's pancreatic cancer. The taxpayer's insurance did not cover all the expenses associated with his wife's round-the-clock care, and in fact, he eventually had to rely on charitable organizations to help pay for oncologists and other caretakers. However, paying the tax liability due after withholdings were considered would have caused the taxpayer to suffer undue hardship. The Tax Court held that the taxpayer had reasonable cause for failing to pay his 2010 tax liability. Although this case has no precedential value,<sup>44</sup> it illustrates that courts do consider the unique circumstances of a taxpayer's case and can reach a just result.

### Estimated Tax Penalty

Courts routinely found taxpayers liable for the IRC § 6654 estimated tax penalty when the IRS proved the taxpayer:

- Had a tax liability;
- Had no withholding credits;
- Made no estimated tax payments for that year; and
- Offered no evidence to refute the IRS.

The IRS has the burden under IRC § 7491(c) to produce evidence that IRC § 6654(d)(1)(B) requires an annual payment from the taxpayer.

<sup>40</sup> IRC §§ 6651(a)(2), (g)(2).

<sup>41</sup> See *Wheeler v. Comm'r*, 127 T.C. 200, 210 (2006), *aff'd*, 521 F.3d 1289 (10th Cir. 2008).

<sup>42</sup> *Nutrition Formulators, Inc. v. Comm'r*, T.C. Memo. 2016-60.

<sup>43</sup> *Ibarra v. Comm'r*, T.C. Summ. Op. 2015-70.

<sup>44</sup> See IRC § 7463(b).

In *Evans v. Commissioner*, the IRS determined that the taxpayer was liable for an IRC § 6654(a) addition to tax of \$8,840 for TY 2009.<sup>45</sup> To meet its burden of production under IRC § 7491(c), the IRS had to show that the taxpayer had a “required annual payment” as defined in IRC § 6654(d)(1)(B). This burden requires the IRS to produce evidence that allows the court to determine the amount of the required annual payment. To determine the amount of the taxpayer’s required annual payment for 2009, the court needed to know whether the taxpayer filed a return for the preceding tax year and if so, the amount of the “tax shown” on that return. Therefore, it was required that the IRS produce evidence that the taxpayer filed a tax return for 2008, and if so, the amount of “tax shown” on that return. In this case, the IRS was unable to meet its burden of production. The IRS’s opening brief contained no findings of fact regarding whether the taxpayer filed a tax return for TY 2008, and if so, the amount shown on that return. The only evidence that the IRS produced regarding the filing of a 2008 tax return was a transcript of account for TY 2008. The court reviewed the transcript and found it “inscrutable” in regards to whether or not a tax return was filed in 2008 or if the IRS later issued a Statutory Notice of Deficiency (SNOD) for that tax year.

The taxpayer provided a copy of his 2008 tax return. For the purpose of the required annual payment, the taxpayer must have sent it prior to the issuance of a SNOD. Because the Tax Court was unable to tell from the transcript when, if ever, the IRS had issued a SNOD for TY 2008, the Tax Court held that the tax return was filed prior to the issuance of a SNOD. The Tax Court determined that the 2008 tax return the taxpayer mailed qualifies as a tax return for the purpose of IRC § 6654. Because the amount shown on the 2008 tax return was zero, the estimated payment due for 2009 was also zero. Therefore, the taxpayer was not liable for the IRC § 6654(a) addition to tax.

## CONCLUSION

Taxpayers prevailed in full in only one of 45 (or two percent) of the failure to file, failure to pay, and estimated tax penalty cases analyzed in this report. Four taxpayers prevailed in part (about nine percent) of the failure to file, failure to pay, and estimated tax penalty cases. Considering the limited resources most taxpayers have when litigating a case against the IRS, and the immense resources possessed by the IRS, a rather low, eleven percent, taxpayer success rate does not seem surprising. Additionally, this is about a six percent decline from the prior year’s success rate (17 percent).<sup>46</sup>

It is critical that IRS employees look closely and thoroughly at the case facts when assessing reasonable cause claims rather than solely relying on the Reasonable Cause Assistant (RCA) software,<sup>47</sup> which is designed to help IRS employees make fair and consistent abatement determinations.<sup>48</sup> The RCA program allows IRS employees to override the results in certain circumstances, but employees must understand the definition of reasonable cause to apply the override.<sup>49</sup> Thus, a close review by an employee is essential to

<sup>45</sup> *Evans v. Comm’r*, T.C. Memo. 2016-7.

<sup>46</sup> National Taxpayer Advocate 2015 Annual Report to Congress 499.

<sup>47</sup> The Reasonable Cause Assistant (RCA) can only consider failure to file or failure to pay penalties for certain individual tax returns.

<sup>48</sup> National Taxpayer Advocate 2010 Annual Report to Congress 198 (Most Serious Problem: *The IRS’s Over-Reliance on Its “Reasonable Cause Assistant” Leads to Inaccurate Penalty Abatement Determinations*). See also IRS, *Reasonable Cause Assistant (RCA) Usability Test Final Report Summary* 4 (May 28, 2010). The test showed that employees using the RCA determined penalty abatement requests correctly in only 45 percent of the cases. An even more disturbing finding was that all of the employees in the study believed they were making correct legal determinations based on reasonable cause.

<sup>49</sup> Internal Revenue Manual (IRM) 20.1.1.3.6.10(3) (Nov. 25, 2011) (“[F]air and consistent application of penalties requires employees to make a final penalty relief determination consistent with the RCA conclusion ... [U]nderstanding that the individual facts and circumstances vary for each case and that there may be unique facts and circumstances in certain cases that RCA cannot consider, an ‘override (abort)’ function is available in RCA.”)

ensure that the failure to file penalty or the failure to pay penalty is imposed appropriately. Additionally, as previously recommended by the National Taxpayer Advocate, Congress should amend IRC § 6404 to authorize the Secretary of the Treasury to grant a one-time abatement of the failure to file penalty (IRC § 6651(a)(1)) and failure to pay penalty (IRC § 6651(a)(2)) for first time filers and taxpayers with a consistent history of compliance, where no countervailing factors are present.<sup>50</sup> To promote voluntary compliance and to uphold a taxpayer's *right to a fair and just tax system* and *the right to pay no more than the correct amount of tax*, the facts of taxpayers' individual cases must be carefully considered.

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50 National Taxpayer Advocate 2001 Annual Report to Congress 188.

MLI  
#7**Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403****SUMMARY**

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or to subject any of the delinquent taxpayer's property to the payment of tax. We identified 32 opinions issued between June 1, 2015, and May 31, 2016 that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 30 of these cases. One case was a split decision. The total number of cases represents approximately a 27 percent decrease from the previous year.<sup>1</sup> This is the second consecutive year that the number of lien enforcement cases decreased. The number of cases dropped by approximately 15 percent in the 2015 reporting period compared to the number of cases in 2014.

**TAXPAYER RIGHTS IMPACTED<sup>2</sup>**

- *The Right to Appeal the IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

**PRESENT LAW**

Internal Revenue Code (IRC) § 7403 authorizes the United States to enforce a federal tax lien with respect to a taxpayer's delinquent tax liability or to subject any property, right, title, or interest in property of the delinquent taxpayer to the payment of a liability, by initiating a civil action against the taxpayer in the appropriate United States District Court.<sup>3</sup> When the United States files a complaint in the United States District Court to enforce a lien under IRC § 7403, it is required to name all parties having liens on or otherwise claiming interest in the relevant property as parties to the action.<sup>4</sup> The law of the state where the property is located determines the nature of a taxpayer's legal interest in the property.<sup>5</sup> However, once it is determined that the taxpayer has an interest under state law in the property, federal law controls whether the property is exempt from attachment of the lien.<sup>6</sup>

IRC § 7403(c) directs the court to “finally determine the merits of all claims to and liens upon the property,” and if the United States proves a claim or interest, the court may order an officer of the court to sell the property and distribute the proceeds in accordance with the court's findings with respect to the interests of the parties, including the United States' claim for the delinquent tax liability.<sup>7</sup> Ordering

1 National Taxpayer Advocate 2015 Annual Report to Congress 509.

2 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

3 IRC § 7403(a); Treas. Reg. § 301.7403-1(a).

4 IRC § 7403(b).

5 *U.S. v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985).

6 *U.S. v. Rodgers*, 461 U.S. 677, 683 (1983).

7 IRC § 7403(c).



the sale of a taxpayer's property is a powerful collection tool and directly affects any parties who have an interest in the property subject to sale. Based on the Supreme Court case *United States v. Rodgers*, however, the court is not required to authorize a forced sale and may exercise limited equitable discretion. Under *Rogers*, when a forced sale involves the interests of a third party who does not have a federal tax debt, the court should consider the following four factors when determining whether the property should be sold:

1. The extent to which the government's financial interests would be prejudiced if they were relegated to a forced sale of the partial interest of the delinquent taxpayer;
2. Whether the innocent third party with a separate interest in the property, in the normal course of events, has a legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or taxpayer's creditors;
3. The likely prejudice to the third party in personal dislocation costs and inadequate compensation; and
4. The relative character and value of the non-liable and liable interests held in the property.<sup>8</sup>

In cases where the United States holds a first priority lien, it may offer bids at the sale of the foreclosed property, up to an amount equal to the amount of the lien, plus selling expenses.<sup>9</sup> If a foreclosure action is initiated by another creditor, then IRC § 7403(c) authorizes the United States to intervene in the action to assert any lien on the property that is the subject of such action.<sup>10</sup>

If the case was initiated in a state court, the United States may remove the case to a U.S. District Court.<sup>11</sup> However, if the foreclosure action is adjudicated under state court proceedings, federal tax liens that are junior to other creditors may be effectively removed, even if the United States is not a party to the proceeding.<sup>12</sup> While the action is pending, the court may appoint a receiver empowered in equity to preserve and operate the property prior to the sale, upon the government's certification that it is in the public interest.<sup>13</sup>

For the Department of Justice (DOJ) to file the foreclosure suit, the IRS must first request that DOJ take such action.<sup>14</sup> The Internal Revenue Manual (IRM) provides procedures with respect to what actions the IRS must take before requesting that the DOJ commence a foreclosure proceeding.<sup>15</sup> With respect to a recommendation to foreclose on a taxpayer's principal residence, there are special procedures that the IRS

<sup>8</sup> *Rogers*, 461 U.S. at 709-11.

<sup>9</sup> IRC § 7403(c).

<sup>10</sup> However, if the application of the United States to intervene is denied, the adjudication will have no effect upon the federal tax lien on the property. IRC § 7424. Under 28 U.S.C. § 2410, the United States may be named a party in any civil action or suit in any district court, or in any state court having jurisdiction of the subject matter.

<sup>11</sup> 28 U.S.C. § 1444.

<sup>12</sup> *U.S. v. Brosnan*, 363 U.S. 237 (1960).

<sup>13</sup> IRC §§ 7403(d) and 7402(a).

<sup>14</sup> IRC § 7401. The IRS prepares a suit recommendation package, and then the IRS Office of Chief Counsel reviews it, and if it agrees sends a letter to the DOJ asking the DOJ to commence the litigation. Chief Counsel Directives Manual, 34.6.1.1.1, *Steps Prior to Litigation*, (Oct. 7, 2015).

<sup>15</sup> Internal Revenue Manual (IRM) 5.17.4.8, *Foreclosure of Federal Tax Lien*, (Aug. 1, 2010).

must follow before initiating a referral to DOJ.<sup>16</sup> The IRM instructs the IRS to refer a case to DOJ to pursue a suit to foreclose only when there are no reasonable administrative remedies and hardship issues. Under IRM procedures, the IRS is required to take the following actions and describe the results in a suit recommendation narrative that accompanies the referral:

- Attempt to personally contact the taxpayer and inform them that a suit to foreclose the tax lien on the principal residence is the next planned action;
- Attempt to identify the occupants of the principal residence;
- Attempt to discuss administrative remedies with the taxpayer such as an offer in compromise (including Effective Tax Administration offer or an offer with consideration of special circumstances), when appropriate;
- Advise the taxpayer about TAS, provide Form 911, *Request for Taxpayer Advocate Assistance (and Application for Taxpayer Assistance Order)*, and explain its provisions;<sup>17</sup> and
- Include a summary statement in the case history, along with the information on the taxpayer and the occupants of the principal residence, including children.<sup>18</sup>

## ANALYSIS OF LITIGATED CASES

We reviewed 32 opinions issued between June 1, 2015, and May 31, 2016, that involved civil actions to enforce federal tax liens. Table 7 in Appendix 3 contains a detailed list of those cases. Fifty-six percent of the taxpayers appeared *pro se* and 44 percent were represented. Taxpayers with representation received partial relief in one case. Generally, *pro se* taxpayers did not fare well and only one received full relief.

### Foreclosure of Tax Liens Where Non-Liable Taxpayer Had Interest in Property

In *United States v. Staton*,<sup>19</sup> the United States filed suit to foreclose on a residence located in Hawaii to satisfy in part the delinquent tax liabilities of Ronald Staton. Mr. Staton owned the residence with his wife, Brenda Staton, as tenants by the entirety.

Since Mrs. Staton was a non-liable third party, the court examined the *Rodgers* factors to determine whether foreclosure of the tax liens would unduly harm Mrs. Staton.<sup>20</sup> The court considered all the *Rodgers* factors and found that they favored the United States' foreclosure action, and thus, the court found

16 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Jan. 8, 2016). In 2012, TAS issued an Advocacy Proposal to the IRS recommending that the IRS consider the negative impact on the taxpayer of a suit to foreclose on a principal residence prior to forwarding the case to the DOJ. TAS, *Memorandum for Director, Collection Policy* (Aug. 20, 2012). The National Taxpayer Advocate followed this advocacy proposal with a legislative recommendation that Congress amend IRC § 7403 to require that the IRS, before recommending that DOJ file a suit to foreclose, first determine whether the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, and that the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer. National Taxpayer Advocate 2012 Annual Report to Congress 537-43 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*). Following this recommendation, TAS worked closely with the IRS to develop an Internal Guidance Memorandum (IGM) to address the issues raised by the National Taxpayer Advocate. Prior to the release of the IGM in 2013, the IRM provisions relating to referring cases under § 6334(e)(1) required the IRS to consider who is living in the residence in determining whether referral to DOJ was appropriate but the procedures under § 7403 did not.

17 If the taxpayer indicates that the planned foreclosure of the principal residence would create a hardship, the Revenue Officer (RO) will assist the taxpayer with the preparation of Form 911 and forward the form to the local TAS office if the RO cannot or will not provide the requested relief.

18 IRM 5.17.4.8.2.5, *Lien Foreclosure on a Principal Residence* (Jan. 8, 2016).

19 *U.S. v. Staton*, 116 A.F.T.R.2d (RIA) 5947 (D. Haw. 2015).

20 *U.S. v. Staton*, 116 A.F.T.R.2d (RIA) 5947 (D. Haw. 2015). For discussion of the *Rodgers* factors, see Present Law section, *supra*.

the entry of an order of foreclosure appropriate.<sup>21</sup> As part of the *Rodgers* analysis, the court considered Mrs. Staton's one-half interest in the residence.<sup>22</sup> The first factor, economic prejudice to the government, favored the foreclosure sale because a sale of a partial interest in the single-family property located on a single lot "would be impractical." Regarding the second factor, Mrs. Staton failed to present any authority that would shield her ownership interest from the sale. After "guess[ing] at her actual expectations as to her property rights," the court determined that she "could have no legally cognizable expectation that the residence could not be sold" to satisfy her husband's tax liabilities. Considering the third factor, the court concluded that there was no potential for unusual dislocation costs or undercompensation to Mrs. Staton. Finally, in regard to the fourth factor, since the ownership interest between liable and non-liable spouses was equivalent (*e.g.*, tenants by the entirety), the court determined that it weighed in favor of a foreclosure sale. The court acknowledged that the Statons were retired, and Mr. Staton had a health problem and that "the Court does not like to see people lose their homes." The court went on to say, however, that DOJ had been working with the Statons for almost three years to resolve the tax problem without the need for the sale and that if the Statons were successful in raising the funds necessary to pay the United States before the sale occurred, the court would immediately stop the sale.

### Impact of Lien Filing and Indexing on Validity of Federal Tax Liens

In *TPF Deeds, LLC v. United States*,<sup>23</sup> the IRS properly assessed taxes against the taxpayer, Ernest Hewlett, in 2004, and then from 2005 to 2009 recorded seven Notices of Federal Tax Liens in Wasatch County, Utah with respect to the outstanding tax liability. In 2006, Ernest Hewlett, along with his wife Colleen Hewlett and their son Michael, purchased real property in Wasatch County. Ernest Hewlett was a one-third owner of the property. When they purchased the property, the federal tax lien attached to Ernest Hewlett's interest. On the same day the property was purchased, it was conveyed to his daughter, Celeste Hewlett. In 2009, Celeste Hewlett financed the property through SourceOne Financial, Inc., which ordered a title report that identified no tax liens or any other exceptions. In less than a month, SourceOne assigned majority interest in the deed to TPF Deeds, LLC. When Celeste Hewlett defaulted on the loan, a nonjudicial foreclosure proceeding was instituted, and a Trustee's Deed was recorded in favor of SourceOne and TPF Deeds for their respective interests. The IRS was not given notice of the nonjudicial foreclosure action. SourceOne discovered there was a tax lien on the property when it tried to sell its interest to a potential buyer and that party's title report showed a Notice of Federal Tax Lien (NFTL) having been filed for the tax liabilities of Ernest Hewlett.

The court found (upon a stipulation by the United States) that six of the seven liens were ineffective against the property.<sup>24</sup> However, the Court held that the lien relating to Ernest Hewlett's tax year 1997 liabilities, for which an NFTL had been filed with the county's Recorder's Office on August 26, 2005, attached to the property and was superior to the plaintiffs' interest in the property. The court found that the lien attached to the property because it was created before Mr. Hewlett acquired a one-third interest in the property.

The court also found the IRS's NFTL filed on August 26, 2005, established a lien superior to the plaintiffs' because the IRS followed the two main requirements of IRC § 6323(f): (1) the filing of the lien in the proper place, and (2) in a proper manner so that a reasonable inspection will reveal it.

21 *U.S. v. Staton*, 116 A.F.T.R.2d (RIA) 5947 (D. Haw. 2015).

22 See *U.S. v. Rodgers*, 461 U.S. 677 (1983).

23 *TPF Deeds, LLC v. U. S.*, 138 F. Supp. 3d 1268 (D. Utah 2015).

24 The government conceded that only one lien, Lien No. 2, or the lien for unpaid federal income taxes for the 1997 tax year, had priority over lenders' interests in the subject property.

The plaintiffs argued that the filing of the NFTL did not satisfy the second prong because when they conducted their search, they did not locate the notice of tax lien filing; hence, it was not filed in a manner so a reasonable inspection would reveal it.<sup>25</sup> The plaintiffs argued that it was not filed in the proper manner because when the plaintiffs searched the taxpayer's full name "Ernest Hewlett" and "Hewlett, Ernest" in the county records, they came up with no results. However, the court pointed out that merely searching Hewlett, or not using commas and quotation marks when searching the taxpayer's full name, yielded results that show that the IRS had filed a NFTL. The court found that the lien was properly recorded so that a reasonable inspection would reveal it and thus had priority over lenders' interests in the subject property.<sup>26</sup>

### Foreclosure of Tax Liens Against Property Held by a Taxpayer's Nominee or Alter Ego

The number of opinions that involved foreclosure of federal tax liens against property titled in the name of a taxpayer's nominee or alter ego showed a slight increase over last year, with 14 in 2016, compared to 13 in 2015. A nominee is one "who holds bare legal title to property for the benefit of another."<sup>27</sup> Courts typically look at the following factors to assess whether an entity is a nominee of a taxpayer:

- The nominee paid no or inadequate consideration;
- The property was placed in the name of the nominee in anticipation of the tax debt or litigation while the transferor retained control;
- There is a close relationship between the transferor and the nominee;
- The parties to the transfer failed to record the conveyance;
- The transferor retained possession (or control); and
- The transferor continues to enjoy the benefits of property.<sup>28</sup>

Courts have also noted that an additional factor to consider is whose funds were used for the purchase of real property.<sup>29</sup> However, the courts have held that no single factor is determinative.<sup>30</sup> In *United States v. Sollenberger*,<sup>31</sup> the court held that several companies set up by members of the Sollenberger family as part of an "asset protection strategy" were merely nominees over which the taxpayers exercised control or alternatively, the entity was a successor of one of the taxpayers.<sup>32</sup> The court also set aside sham mortgage deeds held by the taxpayers over several properties. Since the entities were merely nominees, the court held that the government's liens validly attached to the properties.<sup>33</sup>

25 IRC § 6323(f)(4).

26 The court also rejected the plaintiffs' equitable subordination argument.

27 *Nominee*, BLACK'S LAW DICTIONARY (10th ed. 2014). See also *U.S. v. Beeman*, 108 A.F.T.R.2d (RIA) 5074 (W.D. Penn. 2011).

28 See, e.g., *U.S. v. Sollenberger*, 150 F. Supp.3d 393, 401 - 02 (M.D. Pa. 2015) (citing *U.S. v. Klimek*, 952 F.Supp. 110, 1113 (E.D. PA 1997)); See also *U.S. v. Sabby*, 113 A.F.T.R.2d (RIA) 1335 (D. Minn. 2014) (quoting *Scoville v. U.S.*, 250 F.3d 1198, 1202 (8th Cir. 2001)).

29 *U.S. v. Sollenberger*, 150 F. Supp.3d 393, 402 (M.D. Pa. 2015) (citing *Nobel v. Morchesky*, 697 F.2d 97, 103 (3rd Cr. 1982)).

30 *U.S. v. Sollenberger*, 150 F. Supp.3d, 393, 402 (citing *In re: Richards*, 23 B.R.571, 579 (E.D. Pa. 1999)).

31 *U.S. v. Sollenberger*, 150 F. Supp.3d 393 (M.D. Pa. 2015).

32 *U.S. v. Sollenberger*, 150 F. Supp.3d 393 (M.D. Pa. 2015).

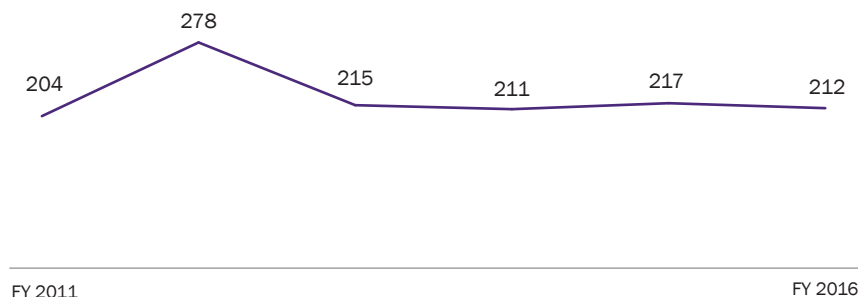
33 *U.S. v. Sollenberger*, 150 F. Supp.3d 393 (M.D. Pa. 2015).

## CONCLUSION

As noted above, this was the second consecutive year that the number of lien enforcement cases decreased. The number of cases dropped by approximately 15 percent from 2014 to 2015 and approximately 27 percent in the past year. It is unclear whether the decrease in the number of litigated cases was directly related to the changes the IRS made in its principal residence referral to DOJ procedures that were instituted in 2013, but with a second consecutive year of decreasing DOJ referrals, the changes seem to have had a positive effect on enforcing taxpayer rights. The number of referrals decreased to 215 in fiscal year (FY) 2013, and slightly fluctuated thereafter, with 211 cases referred in FY 2014, 217 cases referred in FY 2015, and 212 cases referred in FY 2016, as shown in Figure 3.7.1.<sup>34</sup>

**FIGURE 3.7.1**

### Liens Cases Referred to U.S. Department of Justice



The National Taxpayer Advocate anticipates the updated IRM will have a positive effect on taxpayer rights in future years, as the IRS refers fewer suits to foreclose tax liens on taxpayers undergoing a hardship or in situations where there are reasonable alternatives. The National Taxpayer Advocate continues to recommend that Congress adopt the legislative recommendation to codify the approach used in the IRM so it cannot be reversed administratively.<sup>35</sup>

To address taxpayer burden and enhance the taxpayer *rights to privacy, to a fair and just tax system, and to appeal the IRS's decision in an independent forum*, the National Taxpayer Advocate has also recommended that Congress amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to “affected third parties,” known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.<sup>36</sup> Nominee cases represented about 42 percent (14 of 33) of lien cases seen in this reporting period.

<sup>34</sup> National Taxpayer Advocate 2014 Annual Report to Congress 508 (FY 2010 to FY 2013). DOJ Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 2014) and DOJ Tax Division, *Suits to Foreclose Tax Lien – Summary by Fiscal Year of Case Receipt* (Oct. 2015).

<sup>35</sup> National Taxpayer Advocate 2012 Annual Report to Congress 537-43 (Legislative Recommendation: Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences).

<sup>36</sup> National Taxpayer Advocate 2012 Annual Report to Congress 544-52 (Legislative Recommendation: Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions).

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## Charitable Deductions Under IRC § 170

## SUMMARY

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes (AGIs) for contributions of cash or other property to or for the use of charitable organizations.<sup>1</sup> To take a charitable deduction, taxpayers must contribute to a qualifying organization<sup>2</sup> and substantiate contributions of \$250 or more.<sup>3</sup> Litigation generally occurred in this reporting cycle in the following three areas:

- Substantiation of the charitable contribution;
- Valuation of the charitable contribution; and
- Requirements for a qualified conservation easement.

TAS reviewed 26 cases decided between June 1, 2015, and May 31, 2016, with charitable deductions as a contested issue. The IRS prevailed in 19 cases, taxpayers prevailed in three cases, and the remaining four cases resulted in split decisions. Taxpayers represented themselves (appearing *pro se*) in ten of the 26 cases (about 38 percent), with one taxpayer prevailing in full, the IRS in seven cases, and the remaining two resulted in split decisions.

TAXPAYER RIGHTS IMPACTED<sup>4</sup>

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal the IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

## PRESENT LAW

Charitable contributions made within the taxable year are generally deductible by taxpayers, but in the case of individual taxpayers, a taxpayer must itemize deductions from income on his or her income tax return in order to deduct the contribution.<sup>5</sup> Transfers to charitable organizations are deductible only if they are contributions or gifts,<sup>6</sup> not payments for goods or services.<sup>7</sup> A contribution or gift will be allowed as a deduction under IRC § 170 only if it is made “to” or “for the use of” a qualifying organization.<sup>8</sup>

1 Internal Revenue Code (IRC) § 170.

2 To claim a charitable contribution deduction, a taxpayer must establish that he or she made a gift to a qualified entity organized and operated exclusively for an exempt purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual. IRC § 170(c)(2).

3 IRC § 170(f)(8)(A).

4 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

5 IRC §§ 63(d) and (e), 161, and 170(a).

6 The Supreme Court of the United States has defined “gift” as a transfer proceeding from a “detached and disinterested generosity.” *Comm’r v. Duberstein*, 363 U.S. 278, 285 (1960).

7 See also Treas. Reg. § 1.170A-1(g) (no deduction for contribution of services).

8 IRC § 170(c).



For individuals, charitable contribution deductions are generally limited to 50 percent of the taxpayer's contribution base (AGI computed without regard to any net operating loss carryback to the taxable year under IRC § 172).<sup>9</sup> However, subject to certain limitations, individual taxpayers can carry forward unused charitable contributions in excess of the 50 percent contribution base for up to five years.<sup>10</sup> Corporate charitable deductions are generally limited to ten percent of the taxpayer's taxable income and are also available for carryforward for up to five years, subject to limitation.<sup>11</sup> Taxpayers cannot deduct services that they offer to charitable organizations; however, incidental expenditures incurred while serving a charitable organization and not reimbursed, may constitute a deductible contribution.<sup>12</sup>

### Substantiation

For cash contributions, taxpayers must maintain receipts from the charitable organization, copies of cancelled checks, or other reliable records showing the name of the organization, the date, and the amount contributed.<sup>13</sup> Deductions for single charitable contributions of \$250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.<sup>14</sup>

The donor is generally required to obtain the contemporaneous written acknowledgment no later than the date he or she files the return for the year in which the contribution is made, and it must include:

- The name of the organization;
- The amount of cash contribution;
- A description (but not the value) of non-cash contribution;
- A statement that no goods or services were provided by the organization in return for the contribution, if that was the case;
- A description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution; and
- A statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits, if that was the case.<sup>15</sup>

For each contribution of property other than money, taxpayers generally must maintain a receipt showing the name of the recipient, the date and location of the contribution, and a description of the property.<sup>16</sup> When taxpayers contribute property other than money, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.<sup>17</sup> This general rule is subject to certain exceptions that in some cases limit the deduction to the taxpayer's cost basis in the property.<sup>18</sup> For

9 IRC §§ 170(b)(1)(A) and (G).

10 IRC § 170(d)(1).

11 IRC §§ 170(b)(2) and (d)(2).

12 Treas. Reg. § 1.170A-1(g). Meal expenditures in conjunction with offering services to qualifying organizations are not deductible unless the expenditures are away from the taxpayer's home. *Id.* Likewise, travel expenses associated with contributions are not deductible if there is a significant element of personal pleasure involved with the travel. IRC § 170(j).

13 Treas. Reg. § 1.170A-13(a)(1).

14 IRC § 170(f)(8). See also Treas. Reg. § 1.170A-13(f).

15 IRS Pub. 1771, *Charitable Contributions Substantiation and Disclosure Requirements* (Rev. 3-2016).

16 Treas. Reg. §§ 1.170A-13(b)(1)(i) to (iii).

17 Treas. Reg. § 1.170A-1(c)(1).

18 Treas. Reg. § 1.170A-1(c)(1). Note that the deduction is reduced for certain contributions of ordinary income and capital gain property. See IRC § 170(e).

claimed contributions exceeding \$5,000, the taxpayer must obtain a qualified appraisal prepared by a qualified appraiser.<sup>19</sup>

## ANALYSIS OF LITIGATED CASES

TAS reviewed 26 decisions entered between June 1, 2015, and May 31, 2016, involving charitable contribution deductions claimed by taxpayers. Table 8 in Appendix 3 contains a detailed list of those cases. Of the 26 cases, the most common issues were: substantiation (or lack thereof) of the claimed contribution (12 cases), value of the property contributed (five cases), and contribution of an easement (nine cases).<sup>20</sup>

### Qualified Conservation Contribution

For a gift to constitute a qualified contribution under IRC § 170, the donor-taxpayer must possess a transferrable interest in the property and intend to irrevocably relinquish all rights, title, and interest to the property without any expectation of some benefit in return.<sup>21</sup> Taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayer's entire interest in that property.<sup>22</sup> Nevertheless, taxpayers may deduct the value of a contribution of a partial interest in property that constitutes a "qualified conservation contribution,"<sup>23</sup> also known as a conservation easement. A contribution will constitute a qualified conservation contribution only if it is of a "qualified real property interest" made to a "qualified organization" "exclusively for conservation purposes."<sup>24</sup> All three conditions must be satisfied for the donation to be deemed a "qualified conservation contribution."

In *Carroll v. Commissioner*, the taxpayers, a married couple who filed a joint return, attempted to donate a conservation easement on the property on which they resided, and would continue to reside, to the Maryland Environmental Trust and the Land Preservation Trust, Inc. as joint easement holders.<sup>25</sup> In tax years 2005, 2006, 2007, and 2008, the taxpayers claimed a charitable contribution deduction for 2005 and carryover deductions for the subsequent years. The IRS disallowed the non-cash charitable contributions and issued a notice of deficiency. The easement agreement contained language addressing the valuation of the share of the donee organizations in the event of the extinguishment of the easement.<sup>26</sup>

Treasury Regulation § 1.170A-14(g)(6) specifically addresses the valuation of a conservation easement in the event of extinguishment in order to satisfy the "in perpetuity" requirement of IRC § 170 for a qualified conservation easement.<sup>27</sup> The regulations require that a donee receive a vested property interest of the fair market value of the proportionate value of the conservation easement at the time

<sup>19</sup> IRC § 170(f)(11)(C). "Qualified appraisal" and "qualified appraiser" are defined in IRC §§ 170(f)(11)(E)(i) and (ii), respectively.

<sup>20</sup> Cases addressing more than one described issue are counted for each issue. For example, cases addressing the valuation of easements are counted once as a valuation issue case and again as a conservation easement issue case. As a result, the breakdown of case issues above will not add up to the total number of cases reviewed by TAS.

<sup>21</sup> IRC § 170(f)(3).

<sup>22</sup> IRC § 170(f)(3).

<sup>23</sup> IRC § 170(b)(1)(E).

<sup>24</sup> IRC § 170(h)(1)(A)-(C). IRC § 170(h)(4)(B)(i) provides that, in the case of a contribution that consists of a restriction with respect to the exterior of a certified historic structure, the contribution must satisfy two requirements to be considered "exclusively for conservation purposes": 1) the interest must include a restriction which preserves the entire exterior of the building, and 2) the interest must prohibit any change to the exterior of the building that is inconsistent with the historic character of the exterior.

<sup>25</sup> *Carroll v. Comm'r*, 146 T.C. No. 13 (2016).

<sup>26</sup> *Id.*

<sup>27</sup> See Treas. Reg. § 1.170A-14(g)(6) and IRC § 170(h)(5)(A).

of the donation for purposes of determining the proceeds awarded to the donee in the event of an extinguishment of the easement and the sale of the property.<sup>28</sup> For example, if the fair market value of an entire property on the date of the donation was two million dollars and the value of the conservation easement was one million dollars, the donee organization is entitled to a 50 percent interest in the proceeds of the sale of the entire property should the easement be extinguished. In the easement agreement between taxpayers and the donee organizations, taxpayers set the value of the easement, for purposes of extinguishment, at the value of the deduction allowed for federal income tax purposes and subject to change due to any disallowance by the IRS or subsequent court proceedings.<sup>29</sup> The Tax Court held that this language failed to satisfy the in perpetuity aspect of a qualified conservation easement since the value was fixed to the allowed charitable deduction amount and not the fair market value, and a disallowance of the deduction with an extinguishment of the easement would result in a windfall for the taxpayers, or their heirs, since the value of the deduction would then be zero, leaving the donee organizations with no entitlement to the extinguishment proceeds.<sup>30</sup>

A conservation easement must be protected in perpetuity for it to qualify as a “qualified conservation contribution” pursuant to the IRC and Treasury regulations.<sup>31</sup> In last year’s Most Litigated Issue on IRC § 170, we discussed the *Mitchell*<sup>32</sup> case for the premise that a mortgage must be subordinated to the easement at the time of the donation, which has now been cited in other circuits.<sup>33</sup>

### Conservation Easement Valuation

To receive a deduction for most contributions of property in excess of \$5,000, taxpayers must provide a qualified appraisal of the property that is donated.<sup>34</sup> In *Palmer Ranch Holdings LTD v. Commissioner*, the corporate taxpayer owned an 89 acre parcel of land in Sarasota County, Florida, which was home to a bald eagle’s frequent route from a nest to waterways.<sup>35</sup> The corporation donated a conservation easement to the county and took a deduction for over \$25 million.<sup>36</sup> The IRS disallowed the deduction on the basis that the taxpayer had overvalued the worth of the easement.<sup>37</sup> The Tax Court agreed with the taxpayer’s characterization of the highest and best use of the property; however, it still rejected the valuation provided by the taxpayer.<sup>38</sup> Both the taxpayer and the IRS appealed the Tax Court’s decision to the Eleventh Circuit.<sup>39</sup>

In determining the fair market value of a conservation easement, the “before and after” valuation, which compares the values of the property with and without the easement, is generally accepted.<sup>40</sup> The valuation also takes into consideration “any effect from zoning, conservation, or historic preservation

28 Treas. Reg. § 1.170A-14(g)(6)(ii).

29 *Carroll v. Comm’r*, 146 T.C. No. 13 (2016).

30 *Id.*

31 IRC § 170(h)(1); Treas. Reg. § 1.170A-14(g).

32 775 F.3d 1243 (10th Cir. 2015), *aff’g* 138 T.C. 324 (2012).

33 National Taxpayer Advocate 2015 Annual Report to Congress 515-22 (Most Litigated Issue: *Charitable Deductions Under IRC § 170*). See *Minnick v. Comm’r*, 796 F.3d 1156 (9th Cir. 2015), *aff’g* T.C. Memo. 2012-345.

34 IRC § 170(f)(11)(C).

35 812 F.3d 982 at 985 (11th Cir. 2016), *aff’g in part, rev’g in part, and remanding for further proceedings* T.C. Memo. 2014-79.

36 *Id.*

37 *Id.*

38 *Id.* at 992-93.

39 *Id.* at 993.

40 See *Hilborn v. Comm’r*, 85 T.C. 677, 688 (1985); Treas. Reg. § 1.170A-14(h)(3)(i).

laws that already restrict the property's potential highest and best use."<sup>41</sup> Both the taxpayer and the IRS relied heavily on expert opinion testimony as to the pre- and post-contribution values of the property. Ultimately, however, the Tax Court agreed with the taxpayer's experts' view that the highest and best use of the property was moderate density residential zoning. The court characterized the argument from the IRS as being based on hearsay evidence from minutes taken at a board meeting years prior, where a zoning board had speculated on the use of the parcel at hand when deciding a zoning issue related to a contiguous property.<sup>42</sup> Although the Tax Court accepted the highest and best use of the property as presented by the taxpayer's experts, it nonetheless reduced the value of the easement from the proposed \$25,200,000 to \$21,005,278.<sup>43</sup> The Eleventh Circuit affirmed the Tax Court's finding of the highest and best use of the property, but rejected the Tax Court's proposed reduction of the value of the property.<sup>44</sup> The Eleventh Circuit found error in the Tax Court's failure to explain its departure from the comparable sales method of valuation, which was proposed by both the taxpayer and the IRS, and found error in the Tax Court using evidence outside the record to value the property.<sup>45</sup> As a result, the Eleventh Circuit remanded the case to the Tax Court to either use the comparable sales method or explain the departure method, and to stick to only that evidence which was on record for the purposes of making a valuation determination.<sup>46</sup>

### Substantiation

Twelve cases involved the substantiation of deductions for charitable contributions. When determining whether a claimed charitable contribution deduction is adequately substantiated, courts tend to follow a strict interpretation of IRC § 170. Treasury Regulation § 1.170A-13(a)(1) requires the taxpayer to maintain a canceled check or a receipt from the donee organization to substantiate a cash contribution.<sup>47</sup> In the absence of a canceled check or a receipt from the donee organization, the taxpayer must maintain other reliable written records showing the name of the donee and the date and the amount of the contribution.<sup>48</sup>

In *Gracia v. Commissioner*, the married taxpayers filed a timely tax return and claimed \$2,415 in donations which the IRS accepted, and additional contributions of \$390 for travel expenses incurred in performing services for their church, \$3,560 for clothing donations, \$5,350 for cash and property donations.<sup>49</sup> The IRS selected the return for examination. The taxpayers were able to produce one receipt for a \$400 cash donation during the trial. The court found no substantiation for any of the other disputed claimed charitable contributions and disallowed all of them, despite the taxpayers attempting

41 Treas. Reg. § 1.170A-14(h)(3)(ii).

42 812 F.3d 982 at 992 (11th Cir. 2016), *aff'g in part, rev'g in part, and remanding for further proceedings* T.C. Memo. 2014-79.

43 *Id.* at 993.

44 *Id.* at 1002.

45 *Id.* at 1003.

46 *Id.*

47 The IRS issued a Notice of Proposed Rulemaking on Sept. 17, 2015, that would implement the exception to the "contemporaneous written acknowledgment" requirement for substantiating charitable contribution deductions of \$250 or more and would provide rules concerning the time and manner for donee organizations to file information returns that report the requirement information about contributions. See Prop. Treas. Reg. § 1.170A-13(f)(18)-(19), 80 Fed. Reg. 55,802 (Sept. 17, 2015). On Jan. 8, 2016 the IRS withdrew the proposed regulations after receiving numerous comments concerned about the potential for identity theft when providing a donee organization donors' taxpayer identification numbers and requiring the donee to maintain that information for several years. IRS, *Withdrawal of Notice of Proposed Rulemaking*, FR Doc. 2016-189 (Jan. 8, 2016).

48 Treas. Reg. § 1.107A-13(a)(1)(iii).

49 T.C. Memo. 2016-21.

to create a log of items donated and securing a letter purporting to detail donations to an unattended clothing bin, as neither document was a contemporaneous writing.<sup>50</sup>

## CONCLUSION

IRC § 170 and the accompanying Treasury Regulations provide detailed requirements with which taxpayers must strictly comply. The statutory and regulatory requirements to qualify for a deduction become more stringent as deductions increase in size. Most of the charitable contribution cases reviewed this year addressed issues regarding substantiation of contributions or the complex rules governing the donation of a conservation easement.

Due to the complex nature of the rules and regulations surrounding charitable contributions, it is likely that litigation will continue in this area of the law. Taxpayers must carefully follow all aspects of the relevant laws and regulations when attempting to make a charitable contribution. Particularly, taxpayers must pay attention to the requirements for substantiation of a charitable contribution and to the elements of donating a qualified conservation easement.

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50 T.C. Memo. 2016-21. The IRS initially allowed \$2,415 in cash charitable contributions claimed on the taxpayers' tax return. At issue in the trial were additional contributions of \$400 in cash, which the taxpayers substantiated at trial: \$390 for travel expenses related to charitable activities, \$3,560 of donated clothing and \$5,350 of additional cash and gifts. The taxpayers were unable to substantiate the latter three items.

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#9Frivolous Issues Penalty Under IRC § 6673 and Related  
Appellate-Level Sanctions

## SUMMARY

From June 1, 2015 through May 31, 2016, the federal courts issued decisions in at least 19 cases involving Internal Revenue Code (IRC) § 6673 “frivolous issues” penalty and in at least five cases involving similar penalties at the appellate level.<sup>1</sup> These penalties are imposed for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.<sup>2</sup> In five of the cases TAS reviewed, taxpayers escaped liability for the penalty and two cases resulted in a split decision on the requested penalties.<sup>3</sup> Additionally, in three cases, the courts raised the issue of penalties *sua sponte* and did not impose the contemplated penalties but warned the taxpayers they could face sanctions for similar conduct in the future.<sup>4</sup> Nonetheless, TAS included these cases in its analysis to illustrate what conduct will and will not be tolerated by the courts.

TAXPAYER RIGHTS IMPACTED<sup>5</sup>

- *The Right to Appeal an IRS Decision in an Independent Forum*

## PRESENT LAW

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.<sup>6</sup> The maximum penalty is \$25,000.<sup>7</sup> In some cases, the IRS requests that the Tax Court impose the penalty.<sup>8</sup> In other cases, the Tax Court exercises its discretion, *sua sponte*,<sup>9</sup> to consider whether the penalty is appropriate.

- 1 One of these cases also reviewed the Tax Court’s imposition of the Internal Revenue Code (IRC) § 6673 penalty; it is only counted once, our total case count is 23 distinct cases. See *Myers v. Comm’r*, 630 F. App’x 207 (4th Cir. 2016) (denying the Commissioner’s motion for sanctions but upholding \$5000 IRC § 6673 penalty), *aff’g* T.C. docket No. 30321-13L (May 28, 2015).
- 2 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts may impose the penalty under IRC § 6673(b)(1). U.S. Courts of Appeals are authorized to impose sanctions under IRC § 7482(c)(4), 28 U.S.C. § 1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.
- 3 See, e.g., *Hare v. Comm’r*, T.C. Memo. 2015-250.
- 4 “*Sua sponte*” means without prompting or suggestion, on its own motion. BLACK’S LAW DICTIONARY (10th ed. 2014). Thus, for conduct that it finds particularly offensive, the Tax Court can choose to impose a penalty under IRC § 6673 even if the IRS has not requested the penalty. See, e.g., *Shakir v. Comm’r*, T.C. Memo. 2015-147.
- 5 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 6 IRC § 6673(a)(1)(A), (B), and (C).
- 7 IRC § 6673(a)(1).
- 8 The standards for the IRS’s decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual. See Chief Counsel Directives Manual (CCDM) 35.10.2 (Aug. 11, 2004). For sanctions of any attorney or other person authorized to practice before the Tax Court, under IRC § 6673(a)(2), all requests for sanctions are reviewed by the designated agency sanctions officer (currently the Associate Chief Counsel (Procedure & Administration)). This review ensures uniformity on a national basis. See, e.g., CCDM 35.10.2.2.3 (Aug. 11, 2004).
- 9 See, e.g., *Crummey v. Comm’r*, T.C. Memo. 2016-9, *appeal docketed*, No. 16-60620 (5th Cir. Sept. 16, 2016).



Taxpayers who institute actions in United States District Courts under IRC § 7433<sup>10</sup> for certain unauthorized collection actions can be subject to a maximum penalty of \$10,000 if the court determines the taxpayer's position in the proceedings is frivolous or groundless.<sup>11</sup> In addition, IRC § 7482(c)(4) (United States Courts of Appeal and the Supreme Court),<sup>12</sup> §§ 1912 (United States Courts of Appeal and the Supreme Court) and 1927 (all federal courts) of Title 28 of the U.S. Code,<sup>13</sup> and Rule 38 of the Federal Rules of Appellate Procedure (United States Court of Appeals)<sup>14</sup> (among other laws and rules of procedure) authorize various federal courts to impose penalties against taxpayers or their representatives for raising frivolous arguments or using litigation tactics primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in nontax cases, this report focuses primarily on the IRC § 6673 penalty.

## ANALYSIS OF LITIGATED CASES

We analyzed 19 opinions issued between June 1, 2015, and May 31, 2016, in which courts addressed the IRC § 6673 penalty. Thirteen of these opinions were issued by the Tax Court, and six were issued by U.S. Courts of Appeals in cases brought by taxpayers seeking review of the Tax Court's imposition of the penalty. The Courts of Appeals sustained the Tax Court's position in all six cases. Five decisions were issued by other courts on similar penalties (one of these cases also reviewed the Tax Court's imposition of the IRC § 6673 penalty; it is only counted once, our total case count is 23 distinct cases).<sup>15</sup>

In seven cases, the Tax Court imposed penalties under IRC § 6673, with the amounts ranging from \$1,000 to \$15,000. In four cases, taxpayers prevailed when the IRS asked the court to impose a penalty, and in one case, the court fined the taxpaying husband but not the taxpaying wife, resulting in a split decision.<sup>16</sup> In most of these cases, the court warned the taxpayers not to bring similar arguments in the future.<sup>17</sup> All taxpayers appeared *pro se* (represented themselves) before the Tax Court. The taxpayers presented a wide variety of arguments that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts almost invariably cited the language set forth in *Crain v. Commissioner*:

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- 10 IRC § 7433(a) allows a taxpayer a civil cause of action against the United States if an IRS employee intentionally or recklessly, or by reason of negligence, disregards any IRC provision or Treasury regulation in connection with collecting the taxpayer's federal tax liability.
- 11 IRC § 6673(b)(1).
- 12 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court's decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer's position in the appeal was frivolous or groundless.
- 13 28 U.S.C. § 1912 provides that when the Supreme Court or a United States Court of Appeals affirms a judgment, the court has the discretion to award to the prevailing party just damages for the delay, and single or double costs. 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and troublesome multiplying proceedings; such person may be required to personally pay the excess costs, expenses, and attorneys' fees reasonably incurred because of his or her conduct.
- 14 Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.
- 15 See *Myers v. Comm'r*, 630 F. App'x 207 (4th Cir. 2016) (denying the Commissioner's motion for sanctions but upholding \$5000 IRC § 6673 penalty), *aff'g* T.C. docket No. 30321-13L (May 28, 2015).
- 16 See *Stanley v. Comm'r*, T.C. Memo. 2016-26.
- 17 See, e.g., *Martens v. Comm'r*, T.C. Memo. 2015-213.

We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system — including the role played within that system by the Internal Revenue Service and the Tax Court — has long been established.<sup>18</sup>

In the Tax Court cases TAS reviewed, taxpayers raised the following issues that the court deemed frivolous. Consequently, the taxpayers were subject to a penalty under IRC § 6673(a)(1), or, in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future if the taxpayers maintained the same positions:

- **Taxes and procedures to collect taxes are unconstitutional:** TAS identified two cases this year where taxpayers made arguments that taxes or how they are collected are unconstitutional.<sup>19</sup> The taxpayers in these cases advanced common arguments regarding the constitutionality of the income tax and procedures to collect it, including that their Fifth Amendment rights were denied and that they were not afforded due process under the Fourteenth Amendment. Both courts in these cases imposed penalties on the taxpayers.
- **IRS forms and notices violate the Paperwork Reduction Act (PRA) because they do not display a valid Office of Management and Budget (OMB) Control Number:** In at least one case, the taxpayer argued that IRS forms and notices violated PRA, and therefore he had no duty to file a tax return.<sup>20</sup> The taxpayer asserted that OMB had not approved IRS Form 1040, *U.S. Individual Income Tax Return*, in violation of the PRA. The court raised the issue *sua sponte* but declined to impose the penalty, and instead warned the taxpayer against future similar behavior.
- **Taxpayers are not United States persons or wages are not income:** Taxpayers in at least four cases presented arguments that they are not United States persons subject to tax or that wage income is not taxable.<sup>21</sup> In one case, a taxpayer argued that the definition of income is a cat with a pink bow, and he earned no income.<sup>22</sup> The court imposed a penalty of \$3,500 in this case.

## CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated every year, which the courts routinely and universally reject.<sup>23</sup> Of the 23 cases reviewed, taxpayers avoided the IRC § 6673 penalty where the IRS requested it in only four cases and one split decision; the Tax Court often warned the taxpayers in these cases not to bring similar arguments in the future. Moreover, even when the Tax Court acknowledges that a penalty will likely not dissuade the taxpayer from raising frivolous arguments in the future, it nonetheless recognizes that the penalty “serves as a warning to other taxpayers considering these or similar arguments.”<sup>24</sup> Where the IRS has not requested the penalty, the court may

18 *Crain v. Comm’r*, 737 F.2d 1417, 1417-18 (5th Cir. 1984). See, e.g., *Foryan v. Comm’r*, T.C. Memo. 2015-114.

19 See *Clark, U.S. v.*, 642 F. App’x 614 (7th Cir. 2016), *aff’g* 116 A.F.T.R.2d (RIA) 5229 (E.D. Wis. 2015); *Briggs v. Comm’r*, T.C. Memo. 2016-86.

20 See *Shakir v. Comm’r*, T.C. Memo. 2015-147.

21 See, e.g., *Foryan v. Comm’r*, T.C. Memo. 2015-114; *Leyshon v. Comm’r*, T.C. Memo. 2015-104, *aff’d by docket* No. 15-2020 (4th Cir. May 20, 2016).

22 *Bruhwiller v. Comm’r*, T.C. Memo. 2016-18.

23 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 523-26.

24 *Nitschke v. Comm’r*, T.C. Memo. 2016-78, *motion to vacate denied* (June 2, 2016).

nonetheless raise the issue *sua sponte*, and in all cases identified either imposed the penalty or cautioned the taxpayer that similar future behavior will result in a penalty.<sup>25</sup>

Finally, the U.S. Courts of Appeals have shown their willingness to uphold the penalties imposed by the Tax Court without fail in the cases analyzed for the period between June 1, 2015, and May 31, 2016, continuing a trend of upholding all penalties in cases TAS has analyzed since June 2005.

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<sup>25</sup> See, e.g., *Crummey v. Comm’r*, T.C. Memo. 2016-9 (court raised the issue *sua sponte* and warned the taxpayer not to assert similar arguments in the future).

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## Trust Fund Recovery Penalty (TFRP) Under IRC § 6672

## SUMMARY

The trust fund recovery penalty (TFRP) (also known as the 100 percent penalty) applies to a person who has a responsibility to collect, truthfully account for, and pay over “trust fund” taxes imposed on another person that he or she willfully fails to remit such taxes to the IRS.<sup>1</sup> Typically, a TFRP arises when a struggling business fails to remit withheld income taxes, Social Security and Medicare taxes, railroad retirement taxes, or collected excise taxes to the IRS.<sup>2</sup> To establish liability under IRC § 6672, the IRS must conclude a person was responsible for withholding and paying over to the IRS payroll taxes and that the failure to do so was willful.<sup>3</sup> The statute does not contain a reasonable cause exception.<sup>4</sup> Whether a person actually had the responsibility to withhold payroll taxes and whether he or she willfully failed to do so are mixed questions of law and fact frequently litigated in United States district courts, bankruptcy courts, and the Court of Federal Claims. The TFRP has not been a most litigated issue since 2005.<sup>5</sup>

TAXPAYER RIGHTS IMPACTED<sup>6</sup>

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS’s Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to a Fair and Just Tax System*

- 1 Internal Revenue Code (IRC) § 6672(a). IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. Thus, these amounts are referred to as the “trust fund” taxes.
- 2 See generally IRC §§ 3101, 3102, 3111-3113, and 3121-3128 (Federal Insurance Contributions Act (FICA)); IRC §§ 3201, 3202, 3211, 3221, 3231-3233 and 3241 (Railroad Retirement Tax Act (RRTA)); IRC §§ 3301-3311 (Federal Unemployment Tax Act (FUTA)); IRC §§ 3401-3407 (collection of income at source on wages). For excise taxes, see, e.g., IRC §§ 4251; 4261; 4271. IRC § 6672 applies to taxes collected and paid over by a third party. It does not apply to taxes directly imposed on the person or entity required to pay them, e.g., it does not apply to the employer’s share of FICA or FUTA. IRC §§ 3101 and 3301. See also National Taxpayer Advocate 2007 Annual Report to Congress 395-410 (Most Serious Problem: Assessment and Processing of the Trust Fund Recovery Penalty (TFRP)).
- 3 See *Cline v. U.S.*, 997 F.2d 191 (6th Cir. 1993); *McGlothin v. U.S.*, 720 F.2d 6 (6th Cir. 1983).
- 4 There is a split in circuits on the issue of whether reasonable cause could have an effect on a willfulness determination. The Courts of Appeals for the Second, Fifth, Tenth, and Eleventh Circuits have determined that the reasonable cause defense could apply to willfulness determinations under IRC § 6672, but in very limited circumstances. See *Smith v. U.S.*, 555 F.3d 1158, 1170 (10th Cir. 2009); *Thosteson v. U.S.*, 331 F.3d 1294, 1301 (11th Cir. 2003); *U.S. v. Winter*, 196 F.3d 339, 345 (2d Cir. 1999); *Logal v. U.S.*, 195 F.3d 229, 233 (5th Cir. 1999). The Eighth and First Circuits have determined that reasonable cause is not a defense. See *Olsen v. U.S.*, 952 F.2d 236 (8th Cir. 1991); *Harrington v. U.S.*, 504 F.2d 1306 (1st Cir. 1974).
- 5 See National Taxpayer Advocate 2005 Annual Report to Congress 543-48 (Most Litigated Issue: *Trust Fund Recovery Penalty under Internal Revenue Code Section 6672*).
- 6 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

## PRESENT LAW

Internal Revenue Code (IRC) § 6672 provides for assessment of the TFRP against those deemed responsible persons who fail to withhold and remit to the IRS income taxes, employment taxes and certain types of excise taxes, often referred to as the “trust fund” taxes, from payments to employees.<sup>7</sup> To establish liability under IRC § 6672, the IRS must conclude a person was responsible for collecting, accounting for, and paying over payroll taxes to the IRS and have willfully failed to perform any of these activities, or willfully attempted to evade or defeat any such tax or its payment.<sup>8</sup> The term “person” in IRC § 6672 includes, but is not limited to, the following:

- Officer or employee of a corporation;
- Partner or employee of a partnership;
- Member or employee of a Limited Liability Corporation (LLC);
- Corporate director or shareholder;
- Another corporation;
- Surety or lender;
- Payroll Service Provider (PSP);
- Responsible parties within a PSP;
- Professional Employer Organization (PEO);
- Responsible parties within a PEO; and
- Responsible parties within the common law employer (client of PSP/PEO).<sup>9</sup>

TFRP is equal to 100 percent of the trust fund portion of the taxes that were not remitted.<sup>10</sup> TFRP is not dischargeable in bankruptcy.<sup>11</sup> Whether a taxpayer can obtain relief from the TFRP typically depends on whether the taxpayer can demonstrate that he or she was not a “responsible person” or did not act “willfully” under IRC § 6672.<sup>12</sup>

<sup>7</sup> See generally IRC §§ 3101, 3102, 3111-3113, and 3121-3128 (FICA); IRC §§ 3201, 3202, 3211, 3221, 3231-3233 and 3241 (RRTA); IRC §§ 3301-3311 (FUTA); IRC §§ 3401-3407 (collection of income at source on wages). For excise taxes, see, e.g., IRC §§ 4251; 4261; 4271. IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. These taxes are often referred to as the “trust fund” taxes.

<sup>8</sup> *U.S. v. Carrigan*, 31 F.3d 130, 133-34 (3d Cir. 1994). See also *Cline v. U.S.*, 997 F.2d 191 (6th Cir. 1993); *McGlothlin v. U.S.*, 720 F.2d 6 (6th Cir. 1983).

<sup>9</sup> Internal Revenue Manual (IRM) 5.17.7.1.1, *Persons Subject to the Trust Fund Recovery Penalty* (July 18, 2012). Consistent with recommendations by the National Taxpayer Advocate, the IRS has issued internal guidance stating that it can assess the TFRP against third-party payers and updated several IRMs. See also IRM 5.7.3.3.3, *Pre-levy Notice and Collection Due Process (CDP)* (July 19, 2012); Small Business/Self-Employed (SB/SE), *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer*, SBSE-05-0711-044 (July 1, 2011). See National Taxpayer Advocate 2007 Annual Report to Congress 337, 538 (Most Serious Problem: *Third Party Payers*; *Legislative Recommendation: Taxpayer Protection from Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99.

<sup>10</sup> IRC § 6672. TFRP assessments do not include the interest and penalties owed on the underlying employment tax liabilities owed by the employer. See *Williams v. U.S.*, 330 F.2d 960 (2d Cir. 1991). However, interest will begin to accrue on the TFRP if it is not paid within twenty-one days from the date of the notice and demand. IRC § 6601(e)(2).

<sup>11</sup> See 11 U.S.C. §§ 523(a)(1)(A); §507(a)(8)(C).

<sup>12</sup> The IRS also considers collection potential before assessing the TFRP. IRM 5.7.5.1.1(2) (Nov. 12, 2014) states that the penalty will “normally not be assessed when: [t]here is no present or future collection potential” or “[n]either the responsible person nor his or her assets or income sources can be located.”

### Who Is a Responsible Person?

A “responsible person” is someone with significant, not necessarily exclusive, control over the company’s finances.<sup>13</sup> Significant control is the final or significant word over which bills or creditors get paid.<sup>14</sup> The determination of whether one is a responsible person within the meaning of IRC § 6672 is a matter of status, duty, and authority. Courts have recognized the following non-exhaustive five characteristics as being indicative of a person’s status as a “responsible person”:

- Employment as a corporate officer;
- Control over financial affairs;
- The authority to disburse corporate funds;
- Ownership of stock; and
- The ability to hire and fire employees.<sup>15</sup>

In general, the IRS will not seek to assess the penalty against non-owner employees of the business entity who act solely under the control of others and are not in a position to act independently of others.<sup>16</sup> On the other hand, instructions from a superior to not pay taxes do not immunize a person who is otherwise responsible.<sup>17</sup> In addition, the term “responsible person” can include corporations and other artificial entities.<sup>18</sup> More than one person may be determined to be responsible.<sup>19</sup> Each responsible person is jointly and severally liable for the penalty.<sup>20</sup> Even though the IRS may make TFRP assessments against more than one responsible person, it ultimately collects the total amount only once.<sup>21</sup> Responsible persons may seek contribution to allow jointly liable responsible persons to recover a proportionate share from other responsible persons.<sup>22</sup>

### Willfulness

The willfulness component of the statute is satisfied if the person had knowledge of the employer’s obligation to pay withholding taxes and knew the funds were being used for other purposes.<sup>23</sup> Willfulness requires a voluntary, conscious and intentional act but does not require specific criminal intent or evil

13 This control does not need to be absolute. *U.S. v. Carrigan*, 31 F.3d 130, 133 (3d Cir. 1994) (citation omitted).

14 *Quattrone Accountants, Inc. v. IRS*, 895 F.2d 921, 927 (3d Cir. 1990).

15 *E.g., George v. U.S.*, 819 F.2d 1008 (11th Cir. 1987); *Smith v. U.S.*, 555 F.3d 1158 (10th Cir. 2009). When conducting trust fund responsibility interviews with potentially responsible persons, the IRS uses Form 4180, *Report of Interview with Individual Relative to Trust Fund Recovery Penalty*, in order to make a determination regarding responsibility. See IRM 5.7.4.2, *TFRP Interviews and Investigations* (Nov. 12, 2015).

16 IRM 5.7.3.3.1.2, *Non-Owner Employees* (Nov. 12, 2010) (noting that “[i]n general, non-owner employees who act solely under the dominion and control of others, and who are not in a position to make independent decisions on behalf of the business entity, will not be assessed the TFRP”). See also IRM 1.2.14.1.3, *Policy Statement 5-14 (Formerly P-5-60)* (June 9, 2003). “Non-owner employees” are those who do not own any stock, interest, or other “entrepreneurial stake” in the company. IRM 5.7.3.3.1.2(1) (Nov. 12, 2010). See also *U.S. v. Rem*, 38 F.3d 634 (2d Cir. 1994).

17 *E.g., Brounstein v. U.S.*, 979 F.2d 952, 955 (3d Cir. 1992) (citations omitted).

18 *Pac. Nat’l Ins. Co. v. U.S.*, 422 F.2d 26, 30 (9th Cir. 1970).

19 See *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970); *Gephart v. U.S.*, 818 F.2d 469 (6th Cir. 1987).

20 *Brown v. U.S.*, 591 F.2d 1136 (5th Cir. 1979).

21 IRM 1.2.14.1.3, *IRS Policy Statement 5-14 (Formerly P-5-60)* (June 9, 2003).

22 IRC § 6672(d).

23 See *Hochstein v. U.S.*, 900 F.2d 543, 548 (2d Cir. 1990), *cert. denied*, 504 U.S. 985 (1992). A person has acted with willfulness if his or her actions were voluntary, conscious, and intentional as opposed to being merely negligent. See also *Kalb v. U.S.*, 505 F.2d 506, 511 (2d Cir. 1974).



motive.<sup>24</sup> The responsible person bears the burden to prove that his or her actions were not willful.<sup>25</sup> The courts apply these general standards to determine whether a responsible person acted willfully:

- *Deliberate choice* – Willfulness exists where the responsible person knows of the obligation to pay the withholding taxes and makes the deliberate choice to pay the withheld tax funds to other creditors, instead of paying the taxes over to the IRS;<sup>26</sup>
- *Knowledge of nonpayment of taxes* – Willfulness exists if the responsible person obtains knowledge of a withholding tax delinquency and continues to permit payments to be made to other creditors;<sup>27</sup> and
- *Reckless disregard* – Willfulness exists where the responsible person acts with a reckless disregard of a known or obvious risk that withholding taxes will not be remitted, including failing to investigate or correct mismanagement after being notified that withholding taxes have not been paid.<sup>28</sup> Any voluntary act to prefer any creditor over the United States fulfills this criterion.<sup>29</sup>

### Procedural Issues

The IRS conducts an investigation, including interviewing potentially responsible persons, before making an assessment.<sup>30</sup> The period in which the IRS may assess the TFRP against a responsible person is the same period during which the IRS may assess against the employer for the underlying employment tax liability.<sup>31</sup> The responsible person and the IRS may agree to extend the period for assessing the TFRP by executing a Form 2750, *Waiver Extending Statutory Period for Assessment of Trust Fund Recovery Penalty*.<sup>32</sup>

Before the IRS can assess the penalty, however, it must send Letter 1153 (DO), *10-Day Notification Letter, 100% Penalty Proposed Against Filer for Corporation*, to the taxpayer informing him or her of the proposed assessment.<sup>33</sup> In the Letter 1153, the IRS encloses Form 2751, *Proposed Assessment of Trust Fund Recovery Penalty*, setting forth the periods and amounts of the proposed TFRP assessment, and offering the taxpayer an opportunity to appeal the proposed assessment to the Office of Appeals.<sup>34</sup> The taxpayer has 60 days from the date of the letter to submit a written request for appeal.<sup>35</sup> If the taxpayer

24 See, e.g., *Thomas v. U.S.*, 41 F.3d 1109 (7th Cir. 1994); *Barnett v. I.R.S.*, 988 F.2d 1449, 1457 (5th Cir. 1993).

25 See, e.g., *Morgan v. U.S.*, 937 F.2d 281, 286 (5th Cir. 1991).

26 See *Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.3d 1151 (5th Cir. 1979).

27 See, e.g., *Gephart v. U.S.*, 818 F.2d 469 (6th Cir. 1987); *Stettler v. U.S.*, 98-1 U.S.T.C. ¶ 50,136 (10th Cir. 1998); *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970); *Thosteson v. U.S.*, 331 F.3d 1294 (11th Cir. 2003), *cert. denied*, 540 U.S. 1105 (2004).

28 See, e.g., *George v. U.S.*, 819 F.2d 1008 (11th Cir. 1987); *Denbo v. U.S.*, 988 F.2d 1029 (10th Cir. 1993); *Honey v. U.S.*, 963 F.2d 1083 (8th Cir. 1992), *cert. denied*, 506 U.S. 1028 (1992); *Godfrey v. U.S.*, 748 F.2d 1568 (Fed. Cir. 1984); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir. 1979).

29 See *Hochstein v. U.S.*, 900 F.2d 543, 548 (2d Cir. 1990), *cert. denied*, 504 U.S. 985 (1992). Funds that are legally obliged to be paid to another creditor do not fulfill this.

30 IRM 5.7.4.2, *TFRP Interviews and Investigations* (Nov. 12, 2015). The plain language of § 6672 does not oblige the IRS to attempt to collect trust fund taxes from the employer before assessing the TFRP penalty against a responsible person.

31 *Lauckner v. U.S.*, 68 F.3d 69 (3d Cir. 1995), *acq.* 1996-2 C.B. 1.

32 See also Treasury Inspector General for Tax Administration (TIGTA), *Revisions to Trust Fund Recovery Penalty Procedures Are Warranted*, 2016-30-046 (June 30, 2016) (discussing the IRS procedures on TFRP and recommendations).

33 IRC § 6672(b)(1). The IRS's policy is not to pursue the TFRP so long as there is an installment agreement (IA) in place with the business, unless there are statute of limitations issues or a default on IA is entered. IRM 1.2.14.1.3(8) (June 9, 2003).

34 See IRS Letter 1153, *10-Day Notification Letter, 100% Penalty Proposed Against Filer for Corporation* (Mar. 2002).

35 IRM 5.7.6.1.3(2) (Dec. 7, 2012). See also IRC § 6672(b)(2) (providing that the IRS has must send a preliminary notice 60 days prior to the assessment of the penalty). If the penalty per period is over \$25,000, the taxpayer must submit a formal written protest. See 5.7.6.1.5, *Formal Written Protest* (Apr. 13, 2006). Additionally, if the letter is addressed outside of the United States, the taxpayer has 75 days to request an appeal. IRM 5.7.6.1.3(2) (Dec. 7, 2012).

and the IRS still cannot agree on the proposed assessment after the appeals conference, the taxpayer can pay a specified portion of the liability and file a claim for refund in the Court of Federal Claims or the appropriate district court.<sup>36</sup> When the government produces a certificate that the penalty assessments for failure to pay withholding taxes were made, the government is entitled to a presumption of correctness in the courts, while the person challenging the assessment bears the burden of proving by a preponderance of the evidence that he or she was not liable.<sup>37</sup>

## ANALYSIS OF LITIGATED CASES

We reviewed 21 opinions issued by federal courts in which the TFRP was an issue. Taxpayers prevailed in whole or in part in four of the 21 cases. In one of these cases the court denied the IRS's motion for summary judgment, thereby requiring the parties to go to trial on any remaining contested issue.<sup>38</sup> In the remaining cases, the taxpayer prevailed for procedural reasons.<sup>39</sup>

### Pro Se Analysis

Only six of the 21 (29 percent) of the taxpayers in TFRP cases were *pro se*, or unrepresented by counsel. Of these six cases, taxpayers prevailed in one of the cases (approximately 16 percent). Those who were represented for this reporting year actually fared worse than those who represented themselves; they prevailed in whole or in part in only two of the 15 cases (approximately 13 percent). While the issues related to IRC § 6672 are procedurally and substantively complex, and generally require competent counsel, *pro se* taxpayers fared better overall due to the success of two litigants in a substantially smaller pool of cases than the represented taxpayers.

### The IRS Failed to Follow Proper Procedures

In both cases in which the taxpayer prevailed, the IRS failed to follow the pre-assessment procedures for TFRP depriving taxpayers of the *right to challenge the IRS's position and be heard*. In *United States v. Appelbaum*, the court found that the IRS failed to mail the defendant Letter 1153, *10-Day Notification Letter, 100% Penalty Proposed Against File for Corporation*.<sup>40</sup> Because of this failure, assessments made by the IRS prior to the mailing of the letter were not valid. The three year statute of limitations for the IRS to make a valid assessment had already run by the time the case was decided, and so the taxpayer prevailed.

In *Romano-Murphy v. Commissioner*, the court likewise found in favor of the taxpayer because of procedural errors made by the IRS.<sup>41</sup> In this case, the taxpayer was the Chief Operating Officer of Nurses PRN, LLC from July 2002 until June 2005. The IRS sent Romano-Murphy a Letter 1153, *Notice of*

36 IRC § 6672(c) provides that if the taxpayer makes the required payment within 30 days of notice and demand for payment and files suit within 30 days of the IRS denial of refund, levy action will be stayed until the conclusion of the court proceedings. IRS Letter 1153 instructs taxpayers who wish to contest the IRS assessment that they can appeal the assessment without paying the entire TFRP by: (1) paying the contested payroll tax for at least one employee for each period of liability that the taxpayer wishes to contest; (2) filing a claim for refund for the amounts paid using IRS Form 843, *Claim for Refund and Request for Abatement*; and (3) posting a bond with the IRS for 1.5 times the amount of the penalty that is left after making the payment for one employee. As the Trust Fund Recovery cases demonstrate, once the case is filed, the IRS typically counterclaims for the balance of the unpaid liability, thereby placing the entire TFRP liability at issue.

37 *E.g., Fidelity Bank v. U.S.*, 616 F.2d 1181, 1186 (10th Cir. 1980); *Barnett v. U.S.*, 988 F.2d 1449, 1453 (5th Cir. 1993).

38 *Wallis v. U.S.*, 117 A.F.T.R.2d (RIA) 583 (W.D. Va. 2016).

39 *Romano-Murphy v. Comm'r*, 816 F.3d 707 (11th Cir. 2016), *rev'g and remanding* T.C. Memo. 2012-330; *U.S. v. Appelbaum*, 117 A.F.T.R.2d (RIA) 633 (W.D.N.C. 2016), *appeal docketed*, No. 16-1949 (4th Cir. Aug. 19, 2016).

40 *U.S. v. Appelbaum*, 117 A.F.T.R.2d (RIA) 633 (W.D.N.C. 2016), *appeal docketed*, No. 16-1949 (4th Cir. Aug. 19, 2016).

41 *Romano-Murphy v. Comm'r*, 816 F.3d 707 (11th Cir. 2016), *rev'g and remanding* T.C. Memo. 2012-330.

*Proposed Assessment*, in July 2006. In September 2006, Romano-Murphy responded to the letter to request “a conference to discuss the supporting documents contained with her formal written protest.” The IRS did not respond to the letter and the letter was never forwarded to the appeals department. Following a decision in November 2012 by the Tax Court, Romano-Murphy appealed to the Court of Appeals for the Eleventh Circuit. This was the first time that Romano-Murphy raised the issue of the IRS’s failure to provide her with a pre-assessment determination following her response to Letter 1153. The court found that a taxpayer who submitted a timely and written protest to Letter 1153 was entitled to a pre-assessment conference or a final administrative determination to that protest. The court rejected the IRS’s view that it has “unfettered discretion to resolve (or not resolve) timely pre-assessment protests,” and held that the IRS cannot “ignore, disregard, or discard” a timely protest. Because the IRS had never provided a pre-assessment conference and determination to the taxpayer, the taxpayer prevailed and the case was remanded to the Tax Court to determine whether this error was harmless. This is an extremely important decision for taxpayers who seek to resolve TFRP-related disputes pre-assessment because there is no prepayment judicial forum for the trust fund penalty.<sup>42</sup> This case is relevant to protecting the taxpayers’ *right to challenge the IRS’s position and be heard* and the *right to appeal an IRS decision in an independent forum*, specifically the right to participate in the independent administrative appeals process.

### Taxpayer Was a Responsible Person

An individual can be held personally liable under IRC § 6672 if (1) he or she is a “responsible person” and (2) he or she willfully failed to pay over to the government the amount of taxes otherwise due, or willfully attempted in any manner to evade or defeat any such tax or the payment thereof.<sup>43</sup> Once the IRS has made a TFRP assessment, the burden shifts to the taxpayer to disprove one or both elements. As discussed above, a “responsible person” is one who has significant, but not necessarily exclusive, control over a company’s finances and this determination, under IRC § 6672, looks to status, duty, and authority. Specifically, courts look at five, non-exhaustive, characteristics as being indicative of a person’s status as a “responsible person”: (1) employment as a corporate officer; (2) control over financial affairs; (3) the authority to disburse corporate funds; (4) ownership of stock; and (5) the ability to hire and fire employees.<sup>44</sup> There can be more than one “responsible person” for the purposes of IRC § 6672 liability. For example, in *Waterhouse v. United States*, the taxpayer, former vice-president and current 40 percent owner of company, alleged that he was not a “responsible person” since his role was not in the “administrative end of the business.”<sup>45</sup> Despite the court’s acknowledgment that he was not the “primary party responsible for administering [the company’s] finances,” the taxpayer was found a “responsible person” due to his authority to sign checks, history of making financial decisions regarding production and payroll, authority to hire and fire employees, and equal owner of the company.<sup>46</sup>

42 See IRC § 6672(a) (stating that the penalty for TFRP is a “penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.”).

43 IRC § 6672; *McGlothlin v. U.S.*, 720 F.2d 6, 8 (6th Cir. 1982).

44 *E.g.*, *George v. U.S.*, 819 F.2d 1008 (11th Cir. 1987); *Smith v. U.S.*, 555 F.3d 1158 (10th Cir. 2009).

45 *Waterhouse v. U.S.*, 122 Fed. Cl. 276 (2015).

46 *Waterhouse v. U.S.*, 122 Fed. Cl. 276 (2015). See also *Godfrey v. U.S.*, 748 F.2d 1568, 1576 (Fed. Cir. 1984) (stating “where a person has authority to sign the checks of the corporation or to prevent their issuance by denying a necessary signature or where a person controls the disbursement of the payroll or controls the voting stock of the corporation he will generally be held ‘responsible.’”).

### The Availability of Unencumbered Funds Affecting Willfulness

In four cases, taxpayers argued that the willfulness element of the TFRP liability test could be rebutted because TFRP is limited to unencumbered funds.<sup>47</sup> In *Schiffmann v. United States*, taxpayers, the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) of a corporation, argued that they could not be liable for the corporation's unremitted payroll taxes because its funds were "largely encumbered."<sup>48</sup> The court held otherwise, stating that "funds are deemed encumbered only if the taxpayer is legally obligated to use them for some other purpose."<sup>49</sup> Likewise, in *In re Cherne*, the court held that the mere existence of an informal arrangement between the taxpayer's company and a financing company that resembled a "lock box" agreement was not sufficient to hold that those funds were encumbered.<sup>50</sup> In *Ruscitto v. United States*, the taxpayer also unsuccessfully argued that a third party's control of his company's finances under a surety agreement negated a finding of willfulness on his part.<sup>51</sup>

### Conduct Is Willful When the Taxpayer Acted Recklessly

In three cases, the IRS did not show that the taxpayer had actual knowledge of their corporation's failure to remit the proper amount of employment taxes to the IRS.<sup>52</sup> Rather, the IRS showed that the individual had behaved recklessly. For example, in *Byrne v. United States*, the court found the taxpayers liable for the respective corporate payroll taxes for the third and fourth quarters of 2000.<sup>53</sup> Because the taxpayers knew that the fellow investor they entrusted with the responsibility to remit the payroll taxes for 1999 and the first and second quarters of 2000 had not actually done so, their failure to verify that he was performing his duties in the third and fourth quarters of 2000 was reckless.

### Willfulness Is Not Negated Because the Action Is Taken Based on the Directions of Superiors

Taxpayers also argued they are not responsible because the corporate form deprived them of the ability to make the outstanding tax payments. In *Schiffmann v. United States*, for instance, taxpayers (the CEO and CFO of a corporation) argued that their ability to pay the outstanding taxes in particular was not recognized by their board of directors. The court rejected this claim, and found that it was relevant that no resolution was made to this effect by a majority of the board members.<sup>54</sup>

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- 47 *In re Cherne*, 116 A.F.T.R.2d (RIA) 6235 (D. Idaho 2015), *aff'g* 514 B.R. 616 (Bankr. Idaho 2014), *appeal docketed*, No. 15-35802 (9th Cir. Oct. 19, 2015); *Karban v. U.S.*, 117 A.F.T.R.2d (RIA) 1214 (E.D. Mich. 2016), *appeal docketed*, No. 16-1606 (6th Cir. May 11, 2016); *Ruscitto v. U.S.*, 629 F. App'x 429 (3d Cir. 2015), *aff'g* 111 A.F.T.R.2d (RIA) 2166 (W.D. Pa. 2014); *Schiffmann v. U.S.*, 811 F.3d 519 (1st Cir. 2016), *aff'g* 114 A.F.T.R.2d (RIA) 6241 (D.R.I. 2014). When a responsible person is not aware of a tax delinquency, but subsequently becomes aware of the delinquency, he or she is required to use all "unencumbered funds" available to the corporation, including unencumbered funds acquired thereafter, to pay the back taxes. See *Garsky v. U.S.*, 600 F.2d 86, 91 (7th Cir. 1979) (citations omitted).
- 48 *Schiffman v. U.S.*, 811 F.3d 519 (1st Cir. 2016), *aff'g* 114 A.F.T.R.2d (RIA) 6241 (D.R.I. 2014). For funds to be considered "encumbered," the taxpayer must be legally obligated to use the funds for a purpose other than satisfying the preexisting employment tax liability and the legal obligation is superior to the interests of the IRS in the funds, such as a secured creditor. See *Honey v. U.S.*, 963 F.2d 1083, 1090 (8th Cir. 1992), *cert. denied*, 506 U.S. 1028 (1992); *U.S. v. Kim*, 111 F.3d 1351 (7th Cir. 1997).
- 49 *Schiffman v. U.S.*, 811 F.3d 519 (1st Cir. 2016), *aff'g* 114 A.F.T.R.2d (RIA) 6241 (D.R.I. 2014) (citing *Nakano v. U.S.*, 742 F.3d 1208, 1212 (9th Cir. 2014), *cert. denied*, 134 S.Ct. 2680 (2014)).
- 50 *In re Cherne*, 116 A.F.T.R.2d (RIA) 6235 (D. Idaho 2015), *aff'g* 514 B.R. 616 (Bankr. Idaho 2014), *appeal docketed*, No. 15-35802 (9th Cir. Oct. 19, 2015).
- 51 *Ruscitto v. U.S.*, 629 F. App'x 429, 432 (3d Cir. 2015), *aff'g* 111 A.F.T.R.2d (RIA) 2166 (W.D. Pa. 2014).
- 52 *Byrne v. U.S.*, 116 A.F.T.R.2d (RIA) 5502 (E.D. Mich. 2015), *appeal docketed*, No. 15-2396 (6th Cir. Nov. 16, 2015); *Troost v. U.S.*, 116 A.F.T.R.2d (RIA) 6043 (N.D. Tex. 2015), *adopting* 116 A.F.T.R.2d (RIA) 6039 (N.D. Tex. 2015); *U.S. v. Sabaratnam*, 116 A.F.T.R.2d (RIA) 6459 (C.D. Cal. 2015), *appeal docketed*, No. 15-56463 (9th Cir. Sept. 23, 2015).
- 53 *Byrne v. U.S.*, 116 A.F.T.R.2d (RIA) 5502 (E.D. Mich. 2015), *appeal docketed*, No. 15-2396 (6th Cir. Nov. 16, 2015).
- 54 *Schiffman v. U.S.*, 811 F.3d 519 (1st Cir. 2016), *aff'g* 114 A.F.T.R.2d (RIA) 6241 (D.R.I. 2014).

## CONCLUSION

The TFRP cases reviewed often involved officers of small businesses, such as CEOs or CFOs, who had a key role in determining financial expenditures. Often the TFRP liability arose when these companies experienced difficulties, and faced a choice between “borrowing” the trust fund monies, or being unable to remain open. Where the taxpayer made this choice, and the struggling business ultimately failed, the taxpayer faced TFRP under IRC § 6672.

To avoid TFRP liability, a responsible person must use all unencumbered funds to pay the back taxes after he or she obtains knowledge of a trust fund tax delinquency.<sup>55</sup> This duty extends not only to funds available at the time the responsible person becomes aware of the delinquency, but also to any funds acquired thereafter regardless of why the delinquency occurred.<sup>56</sup> This outcome does not change if the delinquency resulted from a third party bad act, such as mismanagement, embezzlement by a trusted employee, or by a third party payer.<sup>57</sup> Sometimes, a responsible person must timely resign to eliminate liability for trust fund taxes collected but not remitted to the IRS after the date of resignation.<sup>58</sup>

The courts’ interpretation of TFRP may cause unjust results when a responsible person of a struggling business tries to resolve past tax delinquency, which resulted from an intervening bad act, and agrees to repay the liability in installments instead of liquidating the business.<sup>59</sup> In order to prevent business owners from facing the dilemma of whether to resign or to attempt to keep the business afloat while repaying the IRS debt, the National Taxpayer Advocate has previously recommended amending IRC § 6672 to provide

55 *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970) (the responsible party knew those taxes were due but nevertheless wrote checks to other creditors and suppliers); *Wright v. U.S.*, 809 F.2d 425 (7th Cir. 1987); *Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir. 1979). Encumbered funds are money that the taxpayer is legally obligated to use for a purpose other than satisfying the preexisting tax liability. The claim of the other creditor must be superior to the IRS. *Honey v. U.S.*, 963 F.2d 1083 (8th Cir. 1992), *cert. denied*, 506 U.S. 1028 (1992); *U.S. v. Kim*, 111 F.3d 1351 (7th Cir. 1997).

56 *Garsky v. U.S.*, 600 F.2d 86 (7th Cir. 1979); *U.S. v. Kim*, 111 F.3d 1351 (7th Cir. 1997). Even if money intended for payment of taxes was embezzled, the responsible party remains liable for the penalty. *Anuforo v. Comm’r*, 106 A.F.T.R.2d (RIA) 5596 (8th Cir. 2010). See also *Purcell v. U.S.*, 1 F.3d 932 (9th Cir. 1993); *Buffalow v. U.S.*, 109 F.3d 570, 573 (9th Cir. 1997).

57 *Anuforo v. Comm’r*, 106 A.F.T.R.2d (RIA) 5596 (8th Cir. 2010); *McCloskey v. U.S.*, 104 A.F.T.R.2d (RIA) 6378 (W.D. Pa. 2009). See also National Taxpayer Advocate 2007 Annual Report to Congress 337, 538 (Most Serious Problem: *Third Party Payers*; *Legislative Recommendation: Taxpayer Protection from Third Party Payer Failures*). See National Taxpayer Advocate 2010 Annual Report to Congress 400, 405 (Legislative Recommendation: *Revise the Willfulness Component of the Trust Fund Recovery Penalty Statute to Encourage Business Owners to Continue Operation of Financially Struggling Businesses When the Tax Liability Accrues Due to an Intervening Bad Act*) (recommending that Congress amend IRC § 6672 to provide that the conduct of a responsible person who obtains knowledge of trust fund taxes not being timely paid because of an intervening bad act shall not be deemed willful if the delinquent business: (1) promptly makes payment arrangements to satisfy the liability based upon the IRS’s determination of the minimal working capital needs of the business, and (2) remains current with payment and filing obligations).

58 See *Maggy v. U.S.*, 560 F.2d 1372 (9th Cir. 1977), *cert. denied*, 439 U.S. 821 (1978).

59 For example, in *Baimbridge v. United States* the potentially responsible person attempted to address the willfulness component of the TFRP liability test by arguing that the corporation had entered into an IA for the repayment of the delinquent tax, and therefore, the IRS should be estopped from assessing the penalties because it was fully aware that the business was going to continue operation and satisfy non-IRS creditors. *Baimbridge v. U.S.*, 335 F. Supp. 2d 1084 (S.D. Cal. 2004). The court noted “that serious injustice may result from a penalty assessment being predicated on non-IRS payments which were contemplated by the installment agreement” and denied the IRS’s motion for summary judgment on the issue of willfulness, thereby requiring the parties to go to trial.



businesses with “working capital” to keep their doors open, while entering into payment arrangements with the IRS.<sup>60</sup>

The IRS assessment of TFRP impacts several important taxpayer rights including the *right to challenge the IRS’s position and be heard, the right to appeal an IRS decision in an independent forum*, and the *right to fair and just tax system*. As discussed in *Romano-Murphy v. Commissioner*, taxpayers have the *right to challenge the IRS’s position and be heard*, including the right to a pre-assessment conference and administrative determination on their timely protest of the proposed TFRP. Additionally, taxpayers have the *right to a fair and just tax system* which takes into consideration all the facts and circumstances that may affect a taxpayer’s underlying liability for TFRP, including if they are a “responsible person,” if they acted willfully, if funds were encumbered or not, and for the IRS to take into consideration any factors that would negate willfulness.

60 See National Taxpayer Advocate 2010 Annual Report to Congress 400-05 (Legislative Recommendation: *Revise the Willfulness Component of the Trust Fund Recovery Penalty Statute to Encourage Business Owners to Continued Operations of Financially Struggling Businesses When the Tax Liability Accrues Due to an Intervening Bad Act*). In cases where the delinquency is due to third party bad acts, such as embezzlement by an employee or third party payer, the courts have not provided any relief to these business owners who opt to spend even a single penny on operating costs rather than providing all available funds to pay back trust fund taxes. See, e.g., *Anuforo v. Comm’r*, 614 F.3d 799 (8th Cir. 2010); *McClouskey v. U.S.*, 104 A.F.T.R.2d (RIA) 6378 (W.D. Pa. 2009). The U.S. Supreme Court has allowed this “minimum working capital,” used to maintain operations and avoided liquidation of the business, and limited the application of the TFRP in cases where a financially troubled company changed ownership and an individual became a responsible person after the liability accrued. See *Slodov v. U.S.*, 436 U.S. 238 (1978). Additionally, the National Taxpayer Advocate recommended that the IRS be given authority to determine “minimal working capital” needs of a financial struggling company, which would be modeled off of the IRC § 7122(d)(2) requirement for allowable living expense analysis, and would require the IRS to conduct a thorough analysis of all facts and circumstances of each taxpayer and ensure that its determination will not leave the taxpayer without adequate funds to meet its basic operating expenses, including current and future tax obligations. National Taxpayer Advocate 2010 Annual Report to Congress 400-05 (Legislative Recommendation: *Revise the Willfulness Component of the Trust Fund Recovery Penalty Statute to Encourage Business Owners to Continued Operations of Financially Struggling Businesses When the Tax Liability Accrues Due to an Intervening Bad Act*).



## TAS Case Advocacy

### OFFICE OF THE TAXPAYER ADVOCATE

Under Internal Revenue Code (IRC) § 7803(c)(2)(A), the Office of the Taxpayer Advocate, known as the Taxpayer Advocate Service (TAS) and led by the National Taxpayer Advocate, has four principal functions:

- Assist taxpayers in resolving problems with the IRS;
- Identify areas in which taxpayers are experiencing problems with the IRS;
- Propose changes in the administrative practices of the IRS to mitigate problems taxpayers are experiencing with the IRS; and
- Identify potential legislative changes that may be appropriate to mitigate such problems.

The first function described in the statute relates to TAS's case advocacy, which involves assisting taxpayers with their cases. This section of the report discusses how TAS fulfills its mission to assist taxpayers with their specific issues and concerns involving IRS systems and procedures.

TAS's other three functions involve identifying and proposing changes to systemic problems affecting taxpayers. TAS employees advocate systemically by:

- Identifying IRS procedures that adversely affect taxpayer rights or create taxpayer burden; and
- Recommending solutions, either administrative or legislative, to improve tax administration.<sup>1</sup>

TAS serves as the voice of the taxpayer within the IRS by providing the taxpayer's view on IRS policies, procedures, or programs. While systemic advocacy is the responsibility of everyone in TAS, primary oversight of systemic advocacy efforts belongs to the Office of Systemic Advocacy. Additionally, TAS administers the Low Income Taxpayer Clinic (LITC) grant program<sup>2</sup> and oversees the Taxpayer Advocacy Panel (TAP).<sup>3</sup>

### TAS CASE RECEIPT CRITERIA

Taxpayers typically seek TAS assistance with specific issues when:

- They have experienced a tax problem that causes financial difficulty;
- They have been unable to resolve their issues directly with the IRS; or
- An IRS action or inaction has caused or will cause them to suffer a long-term adverse impact, including a violation of taxpayer rights.

TAS accepts cases in four categories: economic burden, systemic burden, best interest of the taxpayer, and public policy. See Figure 4.1.1, TAS Case Acceptance Criteria.

1 Taxpayers and practitioners can use the Systemic Advocacy Management System (SAMS) to submit systemic issues to TAS at <http://www.irs.gov/sams>.

2 The Low Income Taxpayer Clinic (LITC) program provides matching grants of up to \$100,000 per year to qualifying organizations to operate clinics that represent low income taxpayers in disputes with the IRS and educate taxpayers for whom English is a second language about their taxpayer rights and responsibilities. LITCs provide services to eligible taxpayers for free or for no more than a nominal fee. See Internal Revenue Code (IRC) § 7526.

3 The Taxpayer Advocacy Panel (TAP) is a Federal Advisory Committee established by the Department of the Treasury to provide a taxpayer perspective on improving IRS service to taxpayers. TAS provides oversight and support to the TAP program. The Federal Advisory Committee Act (5 U.S.C. Appendix (1972)) prescribes standards for establishing advisory committees when those committees will furnish advice, ideas, and opinions to the federal government. See also 41 C.F.R. Part 102-3 (2001).

FIGURE 4.1.1

## TAS Case Acceptance Criteria

As an independent organization within the IRS, TAS helps taxpayers resolve problems with the IRS and recommends changes to prevent future problems. TAS fulfills its statutory mission by working with taxpayers to resolve problems with the IRS.<sup>1</sup> TAS case acceptance criteria fall into four main categories.

|                                      |  |
|--------------------------------------|--|
| <b>Economic Burden</b>               | Cases involving a financial difficulty to the taxpayer; an IRS action or inaction has caused or will cause negative financial consequences or have a long-term adverse impact on the taxpayer                          |
| <b>Criteria 1</b>                    | The taxpayer is experiencing economic harm or is about to suffer economic harm.  |
| <b>Criteria 2</b>                    | The taxpayer is facing an immediate threat of adverse action.  |
| <b>Criteria 3</b>                    | The taxpayer will incur significant costs if relief is not granted (including fees for professional representation).   |
| <b>Criteria 4</b>                    | The taxpayer will suffer irreparable injury or long-term adverse impact if relief is not granted.  |
| <b>Systemic Burden</b>               | Cases in which an IRS process, system, or procedure has failed to operate as intended, and as a result the IRS has failed to timely respond to or resolve a taxpayer issue <sup>2</sup>                                |
| <b>Criteria 5</b>                    | The taxpayer has experienced a delay of more than 30 days to resolve a tax account problem.  |
| <b>Criteria 6</b>                    | The taxpayer has not received a response or resolution to the problem or inquiry by the date promised.   |
| <b>Criteria 7</b>                    | A system or procedure has either failed to operate as intended, or failed to resolve the taxpayer's problem or dispute within the IRS.   |
| <b>Best Interest of the Taxpayer</b> | TAS acceptance of these cases will help ensure that taxpayers receive fair and equitable treatment and that their rights as taxpayers are protected. <sup>3</sup>  |
| <b>Criteria 8</b>                    | The manner in which the tax laws are being administered raises considerations of equity, or have impaired or will impair the taxpayer's rights.  |
| <b>Public Policy</b>                 | TAS acceptance of cases under this category will be determined by the National Taxpayer Advocate and will generally be based on a unique set of circumstances warranting assistance to certain taxpayers. <sup>4</sup> |
| <b>Criteria 9</b>                    | The National Taxpayer Advocate determines compelling public policy warrants assistance to an individual or group of taxpayers.   |

<sup>1</sup> Internal Revenue Code (IRC) § 7803(c)(2)(A)(i).

<sup>2</sup> TAS changed its case acceptance criteria to generally stop accepting certain systemic burden issues. See IRM 13.1.7.3(d) (Feb. 4, 2015).

<sup>3</sup> See IRM 13.1.7.2.3 (Feb. 4, 2015).

<sup>4</sup> See Interim Guidance Memorandum (IGM) TAS-13-1116-009, *Interim Guidance on Accepting Cases Under TAS Case Criteria 9, Public Policy* (Nov. 14, 2016).

In many of the economic burden cases, time is critical. If the IRS does not act quickly (*e.g.*, to remove a levy or release a lien), the taxpayer will experience additional economic harm.<sup>4</sup> Best interest of the taxpayer (Criteria 8) includes breaches of the Taxpayer Bill of Rights (TBOR).<sup>5</sup> With respect to public policy cases (Criteria 9), the National Taxpayer Advocate has the sole authority to determine which issues are included in this criterion and will designate them by memorandum.<sup>6</sup>

## REFINING TAS'S CASE ADVOCACY OPERATIONS

TAS has implemented multiple strategies to focus on effectively advocating for taxpayers.

### TAS Initiative to Expand Local Offices in Underserved Communities

To improve its geographic footprint, TAS continued its focused staffing efforts by realigning resources to currently underserved populations. TAS is using analysis from an earlier review as a reference for future hiring, attrition, and realignment of staffing resources.<sup>7</sup> This model is flexible, enabling TAS to adapt easily to significant IRS changes, changes in demographics, population shifts, and TAS case receipt variations by updating staffing needs on a regular basis. TAS expects its staffing to increase in some locations, but to shrink in others.

In fiscal year (FY) 2016, TAS opened two new offices - San Diego, California in October 2015 and St. Petersburg, Florida in May 2016. TAS consolidated two posts of duty in Austin, Texas in September 2016. Because TAS is increasingly the sole face-to-face option for taxpayers in many areas and familiarity with the community in which the taxpayer lives enhances advocacy, the TAS realignment team will continue to review and update data to reflect long-term staffing plans and needs within available TAS resources.<sup>8</sup>

### TAS Intake Strategy

TAS formally changed its approach to the case intake process as a step in its strategy to focus on its primary mission to serve taxpayers who cannot otherwise resolve their issues with the IRS. Under the TAS Intake Strategy, all intake advocates (Centralized Case Intake (CCI) and field) conduct in-depth interviews with taxpayers to determine the correct disposition of their issue(s). They assist taxpayers with self-help options; take actions where possible to resolve the issue upfront, create cases after validating the taxpayer meets TAS criteria, or refer the taxpayer to the appropriate Business Operation Division (BOD) for assistance. In FY 2014, TAS also formed a partnership with the IRS's Wage and Investment (W&I) BOD under the CCI Proof of Concept and expanded the process to all IRS employees staffing the National Taxpayer Advocate's toll-free line in FY 2015.<sup>9</sup> Under the CCI, IRS employees now transfer calls they believe meet TAS criteria directly to TAS intake advocates through the ASK-TAS1 toll-free line. The

4 IRC § 7803(c)(2)(C)(ii); Internal Revenue Manual (IRM) 13.1.7.2.1, *TAS Case Criteria 1-4, Economic Burden* (Feb. 4, 2015).

5 IRC § 7803(c)(2)(C)(ii); IRM 13.1.7.2.3, *TAS Case Criteria 8, Best Interest of the Taxpayer* (Feb. 4, 2015). See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are now listed in the IRC. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

6 IRC § 7803(c)(2)(C)(ii); IRM 13.1.7.2.4, *TAS Case Criteria 9, TAS Public Policy* (Feb. 4, 2015). See Interim Guidance Memorandum (IGM) TAS-13-1116-009, *Interim Guidance on Accepting Cases Under TAS Case Criteria 9, Public Policy* (Nov. 14, 2016).

7 See National Taxpayer Advocate 2015 Annual Report to Congress 539.

8 See Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*, *supra*, for a discussion of the National Taxpayer Advocate's concerns about the shrinking IRS presence in communities.

9 The National Taxpayer Advocate's toll-free number is 1-877-777-4778.

intake advocates on the TAS toll-free line create cases only after validating that the taxpayers meet TAS criteria and after conducting a robust case intake interview.

In FY 2016, TAS progressed on key objectives to expand CCI, including:

- TAS successfully negotiated the new intake strategy with the National Treasury Employees Union and secured a Memorandum of Understanding (MOU) to move forward with all initiatives under the new strategy. As part of the strategy:
  - TAS successfully “stood-up” the CCI operation under the newly established Executive Director Case Advocacy, Intake and Technical Support (EDCA-ITS) organization; and
  - The EDCA-ITS coordinated live conference calls with all intake advocates and managers of intake advocates in all TAS offices to cover the MOU in its entirety and to address questions.
- The new intake strategy expanded delegated authorities to all intake advocates throughout TAS, granting them authority to resolve more types of taxpayer problems during initial contact, or to take additional actions to resolve or suspend actions before TAS establishes a case and assigns it to a case advocate.<sup>10</sup>
- To complete the rollout of the Intake Strategy to all intake advocates, the EDCA-ITS coordinated extensive training and on-the-job instruction (OJI) plans to support employees. As part of the strategy:
  - TAS committed the necessary resources for two four-day sessions for all intake advocates (CCI and field offices) to participate in face-to-face training on the new intake strategy, their new delegated authorities, and their expanded roles;
  - TAS provided an executive presence in all sessions, using the opportunity to speak with intake advocates about their role as the face of TAS and how they can make a difference for the taxpayer; and
  - TAS is creating a new section within Internal Revenue Manual (IRM) 13.1.16 to provide guidance specifically for all intake advocates.

In FY 2016, TAS intake advocates created cases on 71 percent (53,076 of 74,630) of calls transferred from the NTA toll-free line.<sup>11</sup> Through the CCI process, intake advocates addressed the taxpayers’ concerns in the remaining 29 percent (21,554) of the contacts to avoid opening a new TAS case, allowing TAS to use its specialized skills and resources on situations that are more complex. In FY 2016, the total number of calls transferred to CCI increased nearly 38 percent over FY 2015; however, case creation increased by only 18 percent.<sup>12</sup>

<sup>10</sup> The National Taxpayer Advocate re-delegated certain authorities to intake advocates from Delegation Order 13-2 (Rev. 1).

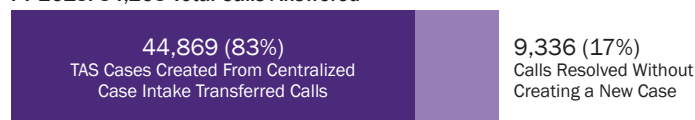
<sup>11</sup> See IRS, *Aspect Application Activity Report*, (Oct. 1, 2015 – Sept. 30, 2016). TAS uses the Taxpayer Advocate Management Information System (TAMIS) to record, control, and process cases and to analyze the issues that bring taxpayers to TAS. TAS retrieved the data for this report on the first day of the month following the end of each fiscal year. Data obtained from TAMIS (Oct. 1, 2016).

<sup>12</sup> See IRS, *Aspect Application Activity Report*, (Oct. 1, 2014 - Sept. 30, 2015, Oct. 1, 2015 - Sept. 30, 2016). Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

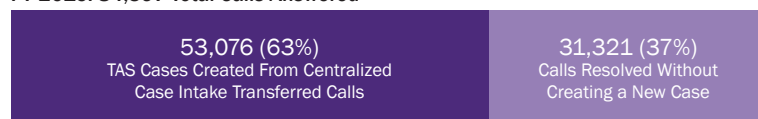
**FIGURE 4.1.2**<sup>13</sup>

### Phone Calls Transferred to the ASK-TAS1 Line and Resulting TAS Cases Created, FYs 2015-2016

**FY 2015: 54,205 Total Calls Answered**



**FY 2016: 84,397 Total Calls Answered**



### Taxpayer Digital Communication (TDC)

TAS is participating in the Taxpayer Digital Communications (TDC) Project,<sup>14</sup> which will allow non-traditional forms of communication between taxpayers and the IRS in its Future State.<sup>15</sup> The National Taxpayer Advocate selected Earned Income Tax Credit (EITC) for inclusion in the TDC to assure that the IRS can show through quantitative analysis that low income taxpayers can or cannot get through IRS systems before the IRS reduces person-to-person assistance in local Taxpayer Assistance Centers (TACs) in the Future State.

The four TAS offices participating in the TDC pilot in FY 2017 are:

- Cleveland, Ohio;
- New Orleans, Louisiana;
- Nashville, Tennessee; and
- Dallas, Texas.

### CASE RECEIPT TRENDS IN FISCAL YEAR (FY) 2016

The Case Advocacy function in TAS has primary responsibility for direct contact with taxpayers, their representatives, and congressional staff. Information from these contacts and the case results are vital to TAS's statutory missions to propose changes in the IRS's administrative practices to alleviate taxpayers' problems and to identify potential legislative changes to relieve such problems. Case Advocacy's findings and results flow into TAS's Systemic Advocacy programs and form the basis for many of the Most Serious Problems and the Legislative Recommendations in this report.

<sup>13</sup> See IRS, *Aspect Application Activity Report*, (Oct. 1, 2014-Sept. 30, 2015, Oct. 1, 2015-Sept. 30, 2016). Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

<sup>14</sup> See Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*; Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted "Best-in-Class" Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*; and National Taxpayer Advocate 2017 Objectives Report to Congress 198 (TAS Technology).

<sup>15</sup> TAS, FY 2016 Program Letter 18 (2016).

### Volume of Cases

In FY 2016, TAS received 209,509 cases, a decrease of nearly eight percent from FY 2015.<sup>16</sup> TAS provided relief to taxpayers in approximately 78 percent of cases closed in FY 2016, consistent with FY 2015.<sup>17</sup> Figure 4.1.3 compares FY 2015 and FY 2016 case receipts and relief rates by case acceptance category.

**FIGURE 4.1.3, TAS Case Receipts and Relief Rates, FYs 2015–2016<sup>18</sup>**

| Case Categories                  | Receipts<br>FY 2015 | Receipts<br>FY 2016 | %<br>Change | Relief Rates<br>FY 2015 | Relief Rates<br>FY 2016 | %<br>Change |
|----------------------------------|---------------------|---------------------|-------------|-------------------------|-------------------------|-------------|
| Economic Burden                  | 135,469             | 119,324             | -11.9%      | 76.2%                   | 74.5%                   | -2.2%       |
| Systemic Burden                  | 91,425              | 89,681              | -1.9%       | 81.7%                   | 82.4%                   | 0.9%        |
| Best Interest of<br>the Taxpayer | 193                 | 382                 | 97.9%       | 75.9%                   | 76.5%                   | 0.8%        |
| Public Policy                    | 102                 | 122                 | 19.6%       | 76.9%                   | 78.3%                   | 1.8%        |
| Total Cases                      | 227,189             | 209,509             | -7.8%       | 78.4%                   | 77.9%                   | -0.6%       |

As noted earlier, in addition to the almost 210,000 cases received in FY 2016, TAS Centralized Intake Advocates addressed 21,554 taxpayer problems through the intake process. The intake strategy allows TAS Case Advocates to focus on the most complex or difficult cases, and those most in need of TAS assistance.<sup>19</sup>

### Case Complexity

TAS monitors the complexity of its work to ensure it meets taxpayers' needs efficiently by assigning workload to match the skills of its employees, by identifying when case advocates need additional resources, such as technical advisor assistance<sup>20</sup> or Counsel advice,<sup>21</sup> and by balancing case inventory levels between TAS offices to ensure prompt action. TAS measures case complexity in a number of ways, including whether a case involves multiple issues or multiple tax periods and whether case advocates need technical advice, thus requiring more resources to resolve the matter.<sup>22</sup> The case advocate must resolve all issues before closing the case.<sup>23</sup> Case advocates must identify primary and secondary core issue codes

16 Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

17 TAS determines relief rates based upon whether it can provide full or partial relief or assistance on the issue initially identified by the taxpayer. Because TAS frequently provides relief on issues that differ from the ones initially identified, the relief rate as calculated is understated. Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

18 Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

19 IRS, *Aspect Application Activity Report*, (Oct. 1, 2015 – Sept. 30, 2016). Data obtained from TAMIS (Oct. 1, 2016).

20 IRM 13.1.12.1.1, *Technical Advisors' Roles and Responsibilities* (Nov. 13, 2009), states in part that "Technical Advisors are responsible for resolving the most technically complex or sensitive issues using effective research, communication, coordination, and negotiating skills."

21 TAS employees often need legal advice to resolve their cases. Attorneys in the Office of Chief Counsel provide legal advice on the correct interpretation of the IRC. See IRC § 7803(b)(2) and IRM 13.1.10.2, *Obtaining Legal Advice From Chief Counsel* (April 9, 2012).

22 IRM 13.4.5.4, *Case Factors Screen* (July 16, 2012). TAS uses a complexity factor screen in its case management system. This screen contains 24 factors, where the presence of any one of these factors indicates greater case complexity. For example, one factor is whether the case involves analysis of the assessment, collection, or refund statute date to determine if it is about to expire.

23 IRM 13.1.21.1.1, *Introduction* (Feb. 1, 2011).



(PCIC and SCIC, respectively) on cases and record them in Taxpayer Advocate Management Information System (TAMIS), as a measure of complexity.<sup>24</sup>

Figure 4.1.4 represents the top ten sources of TAS receipts by PCIC categories from all sources without regard to TAS criteria, comparing FY 2015 and FY 2016. The “Other TAS Receipts” category encompasses the remaining 118 PCICs not in the top ten.<sup>25</sup>

**FIGURE 4.1.4, Top 10 Issues for Cases Received in TAS in FYs 2015–2016**<sup>26</sup>

| Rank | Issue Description   | FY 2015        | FY 2016        | FY 2016 % of Total | % Change FY 2015-FY 2016 |
|------|---|----------------|----------------|--------------------|--------------------------|
| 1    | Identity Theft  | 56,174         | 41,819         | 20%                | -25.6%                   |
| 2    | Pre-Refund Wage Verification Hold                                       | 40,633         | 29,174         | 13.9%              | -28.2%                   |
| 3    | Earned Income Tax Credit (EITC)   | 10,880         | 11,378         | 5.4%               | 4.6%                     |
| 4    | Health Insurance Premium Tax Credit for Individuals Under IRC § 36B     | 3,318          | 10,910         | 5.2%               | 228.8%                   |
| 5    | Processing Amended Return   | 11,847         | 9,671          | 4.6%               | -18.4%                   |
| 6    | Taxpayer Protection Program (TPP) Unpostables                           |                | 7,160          | 3.4%               |                          |
| 7    | Unpostable and Reject   | 6,057          | 6,938          | 3.3%               | 14.5%                    |
| 8    | Processing Original Return  | 7,148          | 6,325          | 3.0%               | -11.5%                   |
| 9    | Reconsideration of Audits and Substitute for Return Under IRC § 6020(b) | 6,723          | 6,264          | 3.0%               | -6.8%                    |
| 10   | Levies  | 7,977          | 5,626          | 2.7%               | -29.5%                   |
|      | Other TAS Receipts  | 76,432         | 74,244         | 35.4%              | -2.9%                    |
|      | <b>Total TAS Receipts</b>   | <b>227,189</b> | <b>209,509</b> | <b>100.0%</b>      | <b>-7.8%</b>             |

Premium Tax Credit (PTC) issues entered the top ten PCICs this year, while levies dropped to the tenth most frequent issue. TAS’s ongoing high volume of Identity Theft (ID Theft) cases indicates that taxpayers continue to face sizeable, complex problems from ID Theft, despite a decline from the previous year.<sup>27</sup>

Erroneous information resulting from ID Theft can affect a victim’s account for multiple tax periods and cause multiple issues, affecting the Accounts Management, Examination, and Collection functions. Other complex cases include collection cases (levy release with alternative collection solutions, return of

24 IRM 13.1.16.13.1, *Issue Codes* (Feb. 1, 2011). IRM 13.1.16.13.1.2, *Primary Core Issue Code* (Feb. 1, 2011), states the primary core issue code (PCIC) is a three-digit code that defines the most significant issue, policy, or process within the IRS that needs to be resolved. IRM 13.1.16.13.1.3, *Secondary Core Issue Code* (Feb. 1, 2011), states that the secondary core issue code (SCIC) identifies secondary issues and is used when a case has multiple issues.

25 TAMIS Coding Reference Guide (Nov. 14, 2016).

26 Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

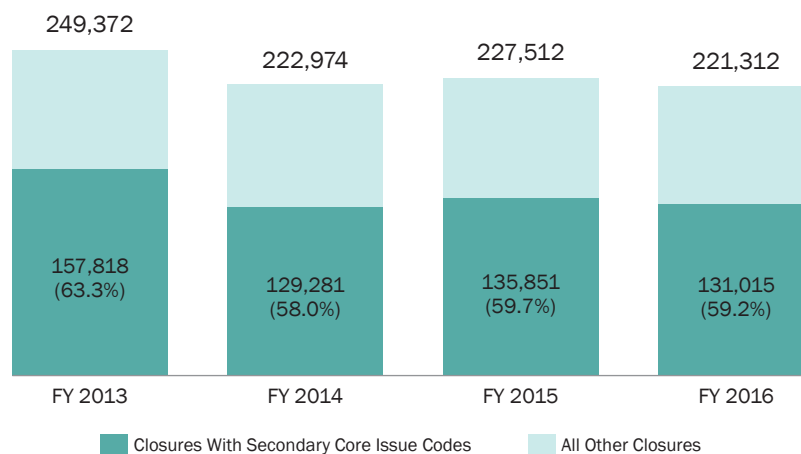
27 See Most Serious Problem: *Fraud Detection: The IRS’s Failure to Establish Goals to Reduce High False Positive Rates for its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *supra*; National Taxpayer Advocate 2015 Annual Report to Congress 180-87 (Most Serious Problem: *Identity Theft (IDT): The IRS’s Procedures for Assisting Victims of IDT, While Improved, Still Impose Excessive Burden and Delay Refunds for Too Long*); National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance That Minimizes Burden and Anxiety for Such Taxpayers*) for a detailed discussion of the identity theft issues.

levy proceeds, offer in compromise (OIC), or seizure prevention), examination cases with multiple periods and technical issues, or income verification cases for self-employed persons with or without EITC issues.

The percentage of cases that TAS closed with one or more SCICs remained consistent over the last year at approximately 60 percent.<sup>28</sup> These numbers indicate that a significant portion of TAS's inventory is very complex, requiring more resources, training, and direct time.

**FIGURE 4.1.5**<sup>29</sup>

#### Closed TAS Cases With Secondary Core Issue Codes



In addition to cases with multiple issues, TAS technical advisors assisted case advocates in understanding and resolving the complex issues in five percent of TAS closed cases in FY 2016.<sup>30</sup> Moreover, over 27 percent of TAS closed cases involved multiple tax periods.<sup>31</sup> Any of these factors can increase the time TAS spends resolving a taxpayer's overall issues.

#### Economic Burden Cases

Economic burden (EB) cases often occur where IRS processes are not functioning smoothly or taxpayers experience other systemic problems. For the fifth consecutive fiscal year, more than half of TAS's case receipts involved taxpayers experiencing EB.<sup>32</sup> Because these taxpayers face potential immediate adverse financial consequences, TAS requires employees to work the cases using accelerated timeframes.<sup>33</sup>

<sup>28</sup> Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

<sup>29</sup> Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

<sup>30</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>31</sup> *Id.*

<sup>32</sup> See National Taxpayer Advocate 2012 Annual Report to Congress 533 (*TAS Case Advocacy*), which reflects that 60.6 percent of TAS case receipts included EB factors in FY 2012. Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

<sup>33</sup> IRM 13.1.16.12(1), *Case Advocate Case Assignment* (Mar. 23, 2011). Upon acceptance into the TAS program, cases are ready for assignment to case advocates within two workdays of the Taxpayer Advocate Received Date (TARD) for Criteria 1-4 cases and three workdays of the TARD for Criteria 5-9 cases. IRM 13.1.18.3(1), *Initial Contact* (May 5, 2016). The TAS employee is to contact the taxpayer or representative by telephone within three workdays of the TARD for criteria 1-4 cases and within five workdays of the TARD for criteria 5-9 cases to notify of TAS's involvement.

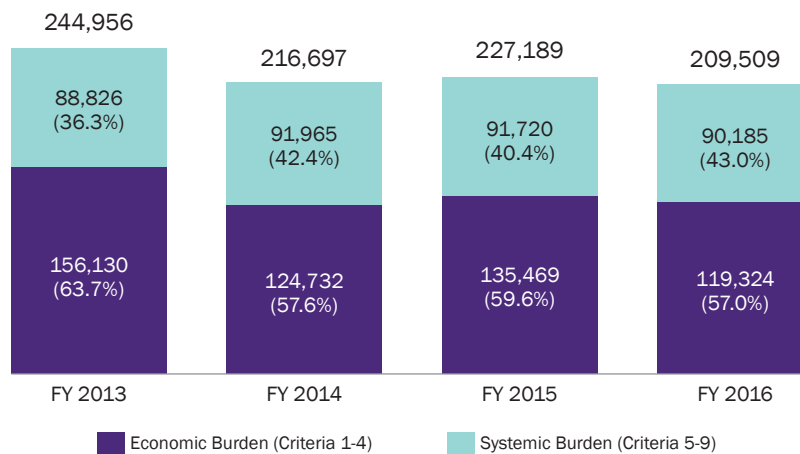
**FIGURE 4.1.6**<sup>34</sup>**TAS Economic and Systemic Burden Receipts**

Figure 4.1.7 shows the top five issues driving EB receipts, which represent the bulk of EB case receipts. TAS dedicates significant resources to resolving the systemic causes of these issues, as discussed in the Most Serious Problems section of this and past reports.

**FIGURE 4.1.7, Top Five Issues Causing Economic Burden, FYs 2015–2016**<sup>35</sup>

| Rank | Issue Description   | FY 2015 | EB Receipts As % Total EB Cases for Issue, FY 2015 | FY 2016 | EB Receipts As % Total EB Cases for Issue, FY 2016 | EB % Change, FY 2015–FY 2016 |
|------|---|---------|--|---------|--|------------------------------|
| 1    | Identity Theft  | 40,284  | 29.7%  | 26,710  | 22.4   | -33.7%                       |
| 2    | Pre-Refund Wage Verification Hold                                   | 25,206  | 18.6%  | 16,442  | 13.8%  | -34.8%                       |
| 3    | Earned Income Tax Credit  | 8,545   | 6.3%   | 8,790   | 7.4%   | 2.9%                         |
| 4    | Health Insurance Premium Tax Credit for Individuals Under IRC § 36B | 2,454   | 1.8%   | 8,644   | 7.2%   | 252.2%                       |
| 5    | Taxpayer Protection Program Unpostables                             |         |  | 5,679   | 4.8%   |                              |

<sup>34</sup> Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

<sup>35</sup> Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016). TAS computed the top five economic burden issue codes using only the PCIC. Often TAS cases involve more than one issue and TAS tracks this data; however, these are not included within this computation to avoid counting a case more than once.

### Identity Theft (ID Theft)

The number one reason for which taxpayers sought assistance in FY 2016 was ID Theft issues.<sup>36</sup> While TAS experienced a decrease in ID Theft case receipts, the decrease is in part due to recording the Taxpayer Protection Program (TPP) cases under a separate issue code.<sup>37</sup> ID Theft cases can be complex, sometimes involving multiple issues, and spanning multiple years. Taxpayers may wait months to receive their tax refunds, and it may take years to work with the IRS to resolve ongoing tax account problems.<sup>38</sup> ID Theft victims often come to TAS to obtain expedited resolution when they are experiencing a hardship.

The National Taxpayer Advocate initially addressed ID Theft as a Most Serious Problem in the 2004 Annual Report to Congress,<sup>39</sup> and she further identified problems and recommended solutions in later reports.<sup>40</sup> Since 2010, TAS has helped over 300,000 ID Theft victims resolve their account problems.<sup>41</sup> In FY 2016, TAS obtained relief for about 81 percent of taxpayers in ID Theft cases.<sup>42</sup> In FY 2016, TAS worked ID Theft cases to their conclusions in 71 days on average, which is significantly less than the IRS's normal processing time of 120 days for most cases and as much as 180 days for more complex cases.<sup>43</sup> TAS closed 45,492 ID Theft cases in FY 2016, including 64 percent with EB.<sup>44</sup>

As Figures 4.1.8 and 4.1.9 demonstrate, TAS had significant ID Theft receipts from FY 2010 to FY 2016, while TAS greatly improved its timeframes for completing ID Theft cases over time.<sup>45</sup> In FY 2016, ID Theft receipts comprised 20 percent of all receipts and over 22 percent of EB receipts.<sup>46</sup> While TAS's case receipts from ID Theft declined, the National Taxpayer Advocate continues to monitor any activities related to processing the returns or correcting the accounts of ID Theft victims.<sup>47</sup>

36 Data obtained from TAMIS (Oct. 1, 2016).

37 See *Taxpayer Protection Program*, *infra*.

38 National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*).

39 See National Taxpayer Advocate 2004 Annual Report to Congress 132-42 (Most Serious Problem: *Inconsistent Campus Procedures*).

40 See Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *supra*; National Taxpayer Advocate 2015 Annual Report to Congress 180-87; National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 44-55; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67; National Taxpayer Advocate 2011 Annual Report to Congress 48-68; National Taxpayer Advocate 2009 Annual Report to Congress 307-11; National Taxpayer Advocate 2008 Annual Report to Congress 79-93; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36.

41 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

42 Data obtained from TAMIS (Oct. 1, 2016).

43 IRM 25.23.2.10, *IDTVA Case Processing Time Frames* (Oct. 13, 2016). Data obtained from TAMIS (Oct. 1, 2016).

44 Data obtained from TAMIS (Oct. 1, 2016).

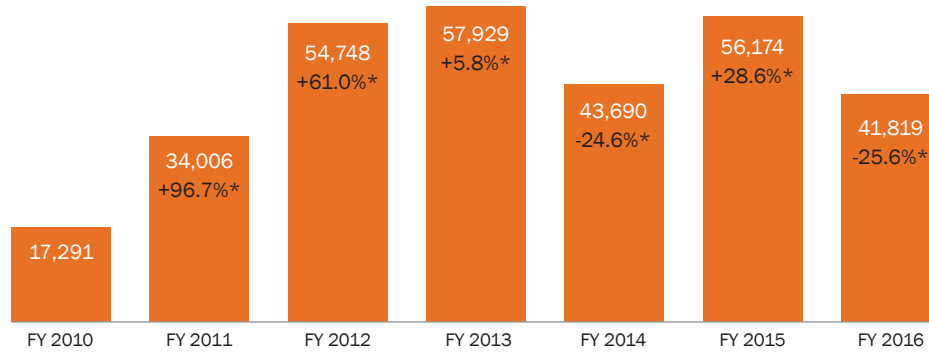
45 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

46 Data obtained from TAMIS (Oct. 1, 2016).

47 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 119-22 (Area of Focus: *The IRS Re-Engineering of Its Identity Theft Victim Assistance Procedures Is a Step in the Right Direction But Does Not Go Far Enough*).

FIGURE 4.1.8<sup>48</sup>

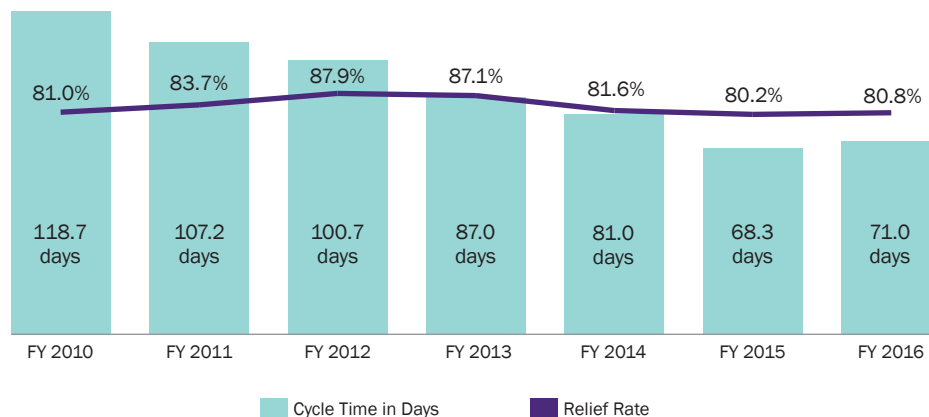
## TAS Identity Theft Case Receipts, FYs 2010-2016



\*Change compared to prior year

FIGURE 4.1.9<sup>49</sup>

## TAS Identity Theft Cycle Time and Relief Rate, FYs 2010-2016



Cycle Time in Days

Relief Rate

## Pre-Refund Wage Verification Holds

The IRS employs various models and data mining techniques in an attempt to prevent issuing fraudulent refunds. For example, the IRS uses the pre-refund wage verification hold (PRWVH) to delay refunds pending wage and withholding verification. When the IRS receives more questionable returns than it has resources to evaluate properly, it places holds on the associated refunds. In the past, the IRS's actions have raised significant taxpayer rights issues and brought increasing numbers of taxpayers to TAS.<sup>50</sup>

48 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

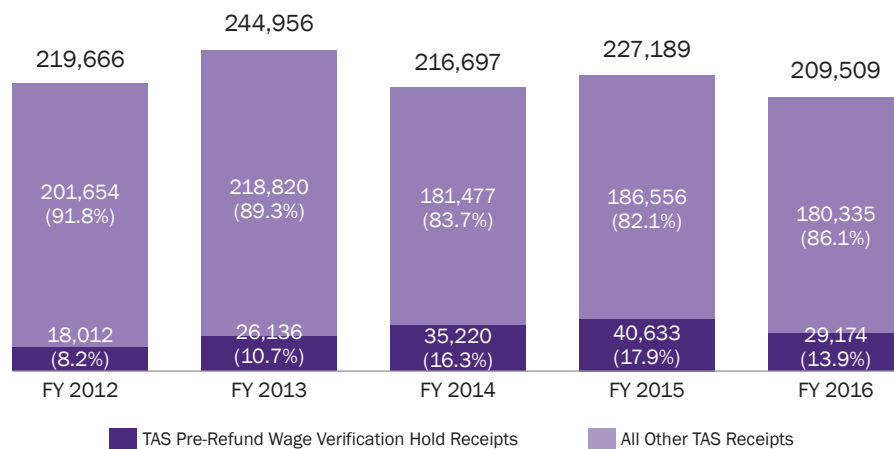
49 *Id.*

50 For a more detailed discussion of this issue, see Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *supra*; National Taxpayer Advocate 2005 Annual Report to Congress 25, addressing the IRS's Questionable Refund Program (subsequently called the Return Integrity and Compliance Services (RICS) program) that failed to provide taxpayers with adequate due process protections and failed to maintain an adequate system to vet the IRS's concerns about taxpayer refund claims.

In FY 2016, while the TAS PRWVH cases declined 28 percent from FY 2015, they again constituted the second most frequent reason that taxpayers came to TAS for assistance. PRWVH cases were nearly 14 percent of TAS's total case receipts in FY 2016.<sup>51</sup> The volume of TAS cases reinforces the concerns about significant systemic and procedural issues in the Return Integrity and Compliance Services (RICS) program.<sup>52</sup>

**FIGURE 4.1.10**<sup>53</sup>

**Pre-Refund Wage Verification Hold Receipts, FYs 2012-2016**



While the National Taxpayer Advocate made recommendations to the IRS regarding systemic improvements to the income verification programs,<sup>54</sup> TAS advocated for the taxpayers who came to TAS when the IRS delayed their refunds under these programs. In FY 2016, TAS achieved an almost 79 percent relief rate and the average cycle time was approximately 59 days.<sup>55</sup>

<sup>51</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>52</sup> See Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *supra*; National Taxpayer Advocate Annual 2015 Report to Congress 45-55 (Most Serious Problem: *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program*). For additional discussion, see National Taxpayer Advocate FY 2016 Objectives Report to Congress 143-45 (Area of Focus: *TAS Receipts Suggest the IRS Needs to Enhance Efforts to Detect and Prevent Refund Fraud*).

<sup>53</sup> Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

<sup>54</sup> The IRS is developing a new fraud detection system. The Return Review Program (RRP) will replace the current Electronic Fraud Detection System (EFDS). The IRS will use a combination of both systems to work the cases in the upcoming filing season due to programming issues. Once the IRS fully implements the RRP, the IRS states it will have the ability to adjust selection criteria in real time to better adapt to emerging patterns of fraud. However, see Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *supra*, and Literature Review: *Reducing "False Positive" Determinations in Fraud Detection*, vol 3, *infra*, for an in-depth discussion of the high false positive rates associated with these programs. See National Taxpayer Advocate 2015 Annual Report to Congress 45-55.

<sup>55</sup> Data obtained from TAMIS (Oct. 1, 2016).

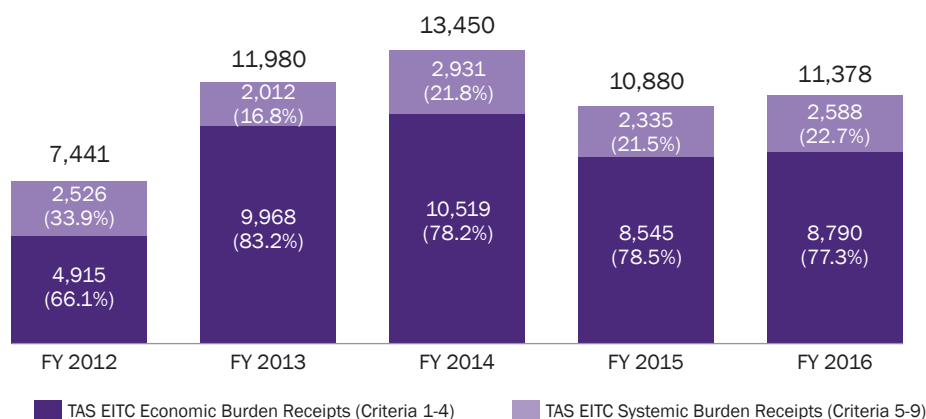


### Earned Income Tax Credit (EITC) Cases

The EITC is a refundable tax credit that provides an economic benefit for low income taxpayers with earned income.<sup>56</sup> In FY 2016, TAS experienced an increase of nearly five percent in EITC receipts from FY 2015.<sup>57</sup> Over 77 percent of the FY 2016 EITC case receipts involved taxpayers experiencing an economic burden, a three percent increase compared to FY 2015.<sup>58</sup>

**FIGURE 4.1.11**<sup>59</sup>

**TAS Earned Income Tax Credit (EITC) Economic and Systemic Burden Receipts, FYs 2012-2016**



The EITC is a complex area of law.<sup>60</sup> The EITC involves eligibility rules based on a taxpayer's income, marital status, and parental or other caretaker arrangements, which can often change from year-to-year.<sup>61</sup>

56 The benefit is available for low income taxpayers without children, but is more significant for those with children. The maximum benefit for tax year 2015 (returns filed in 2016) was \$6,242 for married persons filing jointly with three or more qualifying children. Other filing statuses with no qualifying children could receive up to \$503. IRS Publication 596, *Earned Income Credit (EIC)*, 29-35 (Jan. 6, 2016).

57 Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

58 *Id.* TAS received 8,545 EITC EB receipts in FY 2015 and 8,790 in FY 2016.

59 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

60 See Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *supra*. See Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *supra*, for a legislative proposal to reform the EITC to reduce the complexity and minimize errors and fraud; National Taxpayer Advocate 2015 Annual Report to Congress 248-60 (Most Serious Problem: *EITC: The IRS Is Not Adequately Using the EITC Examination Process as an Education Tool and Is Not Auditing Returns with the Greatest Indirect Potential for Improving EITC Compliance*).

61 In order to claim a child for the EITC, the child must be a "qualifying child" and must meet three tests: age, relationship, and residency. Pursuant to IRC § 32(c)(3)(A), the EITC generally relies on the definition of qualifying child found in IRC § 152. The **Relationship** test requires that the child be the taxpayer's child (including an adopted child, stepchild or eligible foster child), brother, sister, stepbrother, stepsister, or descendant of one of these relatives. See IRC §§ 152(c)(2) and 152(f)(1). The **Residency** test requires that the qualifying child must live with the taxpayer for more than half of the tax year (exceptions apply for temporary absences for special circumstances, e.g., children who were born or died during the year, children of divorced or separated parents, and kidnapped children). See IRC §§ 152(c)(1)(B), (e), (f)(6); and, Treas. Reg. § 1.152-1(b). The **Age** test requires the child be younger than the taxpayer and fall under one of these age categories as of the close of the calendar year: under age 19, under age 24 and a full-time student, or a child of any age who is permanently and totally disabled. See IRC § 152(c)(3).

Taxpayers typically face difficulty when substantiating the residency and relationship requirements, which causes the taxpayers to turn to TAS for assistance. In these cases, documentation requirements can be overwhelming (e.g., the need to obtain birth certificates for various individuals to establish the required relationship for a niece, nephew, or other extended relative).<sup>62</sup> For these taxpayers, proving to the IRS that they are entitled to the EITC is challenging.

TAS has two advocacy opportunities for EITC taxpayers. First, TAS assists the taxpayers with gathering acceptable documentation to prove their EITC claim, and second, TAS educates the taxpayers about EITC rules. To fully advocate for the taxpayer, TAS trained and encouraged case advocates to think “outside the box” for adequate documentation. For example, if the taxpayer lived in several places throughout the year, the TAS case advocate spent time linking various leases, affidavits, and rental receipts to prove residency. For self-employed taxpayers, TAS spoke with third-party customers and secured affidavits when the taxpayer did not keep complete logs of customer service and billing to prove his or her earned self-employment income.<sup>63</sup> TAS urged case advocates to use technical advisors to help assemble the necessary EITC documentation and to assist with presenting a fully developed case to the IRS.

TAS continuously reviews how it advocates in EITC cases. In FY 2016, TAS had presentations on strategies to communicate with, and gather documentation from low income taxpayers, as well as how to present the cases to the IRS. These presentations stressed the benefits of live conversations, which include:

- Allowing interaction with the taxpayer to obtain full knowledge of the facts of the taxpayer’s situation;
- Providing the capability to offer more effective guidance for obtaining necessary documentation; and
- Offering the best delivery method for educating taxpayers about the EITC rules for eligibility and enabling taxpayers to seek clarification of the rules.

### Taxpayer Protection Program (TPP)

The TPP was the sixth largest source of TAS cases overall and the fifth largest source of EB receipts.<sup>64</sup> The taxpayers typically need their refunds expedited to alleviate financial hardships. The IRS uses filters on refund returns to detect and suspend suspicious returns.<sup>65</sup> Through the TPP, the IRS intended to assist legitimate filers to authenticate their suspended returns,<sup>66</sup> while negating losses to the government due to ID Theft. A taxpayer must either call the TPP toll-free line or visit a TAC to verify his identity by answering a series of questions.<sup>67</sup>

62 See National Taxpayer Advocate 2015 Annual Report to Congress 235; National Taxpayer Advocate 2013 Annual Report to Congress 109; National Taxpayer Advocate 2011 Annual Report to Congress 296, 304; National Taxpayer Advocate 2009 Annual Report to Congress 110.

63 See National Taxpayer Advocate 2015 Annual Report to Congress 551 (TAS Case Advocacy: *Earned Income Tax Credit Cases*).

64 TAS did not record data on case receipts specifically from the TPP until January 2016, so TAS does not have FY 2015 data for comparison. Recording the cases separately accounted for a portion of the decrease in IDT case receipts in FY 2016.

65 See Most Serious Problem: *Fraud Detection: The IRS’s Failure to Establish Goals to Reduce High False Positive Rates for its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *supra*; National Taxpayer Advocate 2013 Annual Report to Congress 173-74. Based on prior years’ returns, including those involving “verified” fraud, models are built and implemented for detecting fraud. The IRS passes incoming returns requesting refunds through the knowledge base and scores them for likelihood of fraud. The IRS flags returns that it diverts into a workload for further inspection before it issues any refund. IRS, Kenneth A. Kaufman, *An Analysis of Data Mining in the Electronic Fraud Detection System* (Apr. 28, 2010).

66 IRM 25.25.6.1, *Taxpayer Protection Program* (Aug. 26, 2016).

67 IRM 25.25.6.1, *Taxpayer Protection Program* (May 26, 2015). Identity verification requires answering “Out of Wallet” questions, which are knowledge-based questions about private information not readily available that only the user should know.

In FY 2016, TAS received 7,160 TPP cases, including 5,679 with EB criteria, when taxpayers could not authenticate their identity with the IRS.<sup>68</sup> TAS provided taxpayers with instructions on the types of documents needed to authenticate his return in a TAC. TAS secured relief in 69 percent of TPP cases in an average of 40 days.<sup>69</sup>

### Affordable Care Act (ACA)

In FY 2015, TAS received 3,758 cases in which taxpayers needed assistance with an aspect of the ACA;<sup>70</sup> and it increased to 11,436 cases in FY 2016, more than a 204 percent increase.<sup>71</sup> Of the total FY 2016 ACA receipts, about 95 percent were PTC cases, which accounted for most of the increase in ACA cases.<sup>72</sup>

The majority (about 71 percent) of PTC cases consisted of Error Resolution System/Reject cases.<sup>73</sup> In addition, the FY 2016 Individual Shared Responsibility Payment (ISRP) receipts increased by nearly eleven percent.<sup>74</sup>

TAS also worked cases that involved Form 1040-EZ, *Income Tax Return for Single and Joint Filers With No Dependents*, conversions, when the taxpayers sought assistance in filing the correct forms after they received notices from the IRS regarding errors in their Advanced Premium Tax Credit. TAS encountered cases in which unscrupulous preparers pocketed taxpayers' ISRP instead of transmitting the payments to the IRS.<sup>75</sup> The preparers used a variety of invalid reasons to persuade the taxpayers to deposit the ISRP into the preparers' accounts, such as promising lower ISRP amounts due if paid directly to the preparer. The preparers told some taxpayers that their immigration status did not qualify them for an ISRP exemption, when they actually were exempt and did not owe an ISRP.<sup>76</sup> TAS educated these taxpayers on ISRP and their rights.

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68 Data obtained from TAMIS (Oct. 1, 2016).

69 *Id.*

70 Data obtained from TAMIS (Oct. 1, 2015).

71 Data obtained from TAMIS (Oct. 1, 2016).

72 For a full discussion of these issues, see Most Serious Problem: *Affordable Care Act (ACA): The IRS Has Made Progress in Implementing the Individual and Employer Provisions of the ACA But Challenges Remain*, *supra*. Data obtained from TAMIS (Oct. 1, 2016). TAS received 3,318 Premium Tax Credit (PTC) cases in FY 2015 and 10,910 in FY 2016.

73 Data obtained from TAMIS (Oct. 1, 2016).

74 Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016). TAS received 352 Individual Shared Responsibility Payment (ISRP) cases in FY 2015 and 390 in FY 2016.

75 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 139.

76 IRC § 5000A(d)(3). See also Instructions to Form 8965, *Health Coverage Exemptions*.

### Foreign Account Tax Compliance Act (FATCA)

The IRS's approach to the Foreign Account Tax Compliance Act (FATCA)<sup>77</sup> implementation created significant compliance burdens for a variety of affected parties, including: nonresident aliens, U.S. citizens living abroad, and foreign financial institutions.<sup>78</sup> Taxpayers sought TAS's assistance for these issues.

#### *Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Issue*<sup>79</sup>

The IRS froze the refunds of all taxpayers who filed a Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*, reflecting amounts withheld pursuant to Chapter 3 and Chapter 4, even those supported by the requisite Form 1042-S, for up to 168 days while the IRS attempted to match applicable documentation and satisfy itself fraud had not occurred.<sup>80</sup> The IRS extended the hold timeframe to 12 months.<sup>81</sup> Nevertheless, the IRS did not provide TAS with specific procedures or protocols to follow in order to assist taxpayers to release their refunds.<sup>82</sup> TAS's FATCA withholding case receipts increased from 103 cases in FY 2015 to 774 cases in FY 2016 — an increase of about 650 percent.<sup>83</sup>

Foreign students experienced difficulties in obtaining refunds of withholding tax reported on Form 1042-S.<sup>84</sup> TAS's efforts to assist these taxpayers were hampered by the lack of IRS guidance for over a year as to how the IRS would determine whether Form 1042-S withholding claimed on a tax return matched the Form 1042-S data filed with the IRS.<sup>85</sup>

77 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010).

78 See, e.g., *SIFMA, Comments on the Final FATCA Regulations* (Jun. 21, 2013), 2, <http://www.sifma.org/comment-letters/2013/sifma-submits-comments-to-the-us-department-of-treasury-and-the-irs-on-final-fatca-regulations/>; Treas. Reg. § 1.1474-1(f); Letter from American Citizens Abroad to Jacob Lew, Sec'y, Treasury, and John Koskinen, Cmm'r, IRS (Sept. 16, 2015), <https://www.americansabroad.org/media/files/files/f74d1b79/same-country-exemption-letter.pdf>. The hardships experienced by non-resident aliens occur most often under Chapter 3 of the IRC (IRC §§ 1441-1443), which is not part of FATCA. Nevertheless, as it went about implementing FATCA, the IRS determined that it would begin treating Chapter 3 refund claims synonymously with its treatment of Chapter 4 refunds. See Notice 2015-10, 2015-20 I.R.B. 965. As a result, the issues experienced by non-resident aliens when filing Forms 1040-NR, *U.S. Nonresident Alien Income Tax Return*, seeking amounts shown as withheld on Forms 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, arose. See Most Serious Problem: *The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *supra*.

79 See Most Serious Problem: *Foreign Account Tax Compliance Act (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *supra*; National Taxpayer Advocate 2017 Objectives Report to Congress 80-84.

80 IRM 21.8.1.11.14.2, *FATCA — Programming Beginning January 2015 Affecting Certain Forms 1040-NR (TC 810-3-E Freeze)* (May 1, 2015) (August 1, 2016). See also IRS SERP Alert 15A0188 (Mar. 23, 2015). The IRS informed taxpayers that those who requested a refund of tax withheld on a Form 1042-S by filing a Form 1040-NR will have to wait up to six months from the original due date of the 1040-NR return or the date the 1040-NR was filed, whichever was later, to receive any refund due. As of June 30, 2016, overpayments created by Forms 1042-S credits taken on Forms 1040-NR are no longer systemically frozen.

81 SERP Alert 15A0416 (Sept. 11, 2015).

82 See National Taxpayer Advocate FY 2016 Objectives Report 48-52.

83 Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

84 See Most Serious Problem: *Foreign Account Tax Compliance Act (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *supra*; National Taxpayer Advocate 2017 Objectives Report to Congress 80-84. IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

85 SERP Update 16U0135, *New 1042-S Validation Procedures* (Jan. 19, 2016).

TAS advocated for taxpayers experiencing problems from systemic Chapter 3 and Chapter 4 refund freezes.<sup>86</sup> TAS worked with the Large Business & International (LB&I) Operating Division to develop withholding verification procedures for taxpayers with TAS cases. TAS assigned all FATCA cases to two TAS offices with subject matter experts on international tax issues.<sup>87</sup> In June 2016, the IRS suspended all Form 1042-S processing.<sup>88</sup> LB&I did not have procedures to work the volume of cases, in addition to TAS's OARs.

TAS secured all original returns and performed extensive research before issuing the OARs. Withholding agents were frustrated, because no one could assist them with the errors. Taxpayers received balance due letters, some with intent to levy notices, because the proper withholding credits were not applied to their accounts. Some taxpayers waited more than a year to receive their refunds. In some cases, they received more than one refund, because of the systemic errors.

Eventually, after concerns were raised by the National Taxpayer Advocate and other stakeholders, the IRS announced that it would lift the freezes placed on refunds of withholding tax reported on Forms 1042-S and that it would discontinue its policy of instituting future freezes until it redesigned the process for examining such claims.<sup>89</sup> Nevertheless, some of the problems that had been created in the process required substantial time and effort to rectify. Further, the issues flowing from the use of systemic freezes in the context of refunds to nonresident aliens have not been resolved but simply put on hold.

### *Bulk Operations Assistance Requests (OARs)*<sup>90</sup>

U.S. withholding agents contacted TAS to help them resolve withholding mismatch problems affecting their payees. TAS informed LB&I of its intent to issue a bulk request for assistance for nearly 35,000 taxpayers; however, the temporary systemic solution by LB&I ultimately made the bulk OAR unnecessary. The IRS paid a refund with interest for 7,745 of these taxpayers' returns (37 percent).<sup>91</sup> Of the taxpayers receiving refunds, 5,288 taxpayers waited 306 or more days for their refunds.<sup>92</sup>

### *Difficulty Resolving Operations Assistance Requests (OARs)*

TAS issued 88 percent more OARs to LB&I in FY 2016 compared to FY 2015, mainly because of LB&I's Form 1042-S withholding refund holds process.<sup>93</sup> More taxpayers sought TAS's assistance due to pre-refund compliance activities, which caused economic burden. When LB&I received an OAR seeking

86 See Most Serious Problem: *Foreign Account Tax Compliance Act (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *supra*; National Taxpayer Advocate 2017 Objectives Report to Congress 80-84.

87 TAS assigned these case to its Philadelphia West and International – Puerto Rico offices.

88 SERP Alert 16A0187, *Suspend Processing of IMF Form 1042-S Credits and Denial Inquiries* (June 6, 2016) (rescinded Aug. 19, 2016).

89 IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S*, Foreign Person's U.S. Source Income Subject to Withholding (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

90 For an explanation of bulk Operations Assistance Order (OARs), see *TAS Operations Assistance Request Trends*, *infra*.

91 IRS CDW Individual Master File (IMF) Transaction History table, Individual Returns Transaction File (IRTF) Form 1040 table, TYs 2013–2014, cycle posted 201608. In Aug. 2016, TAS evaluated CDW data on the 36,842 taxpayers that received a 2014 Form 1042-S from payers that used the same software to provide the length of time the taxpayers had to wait and the dollar amounts of their refunds.

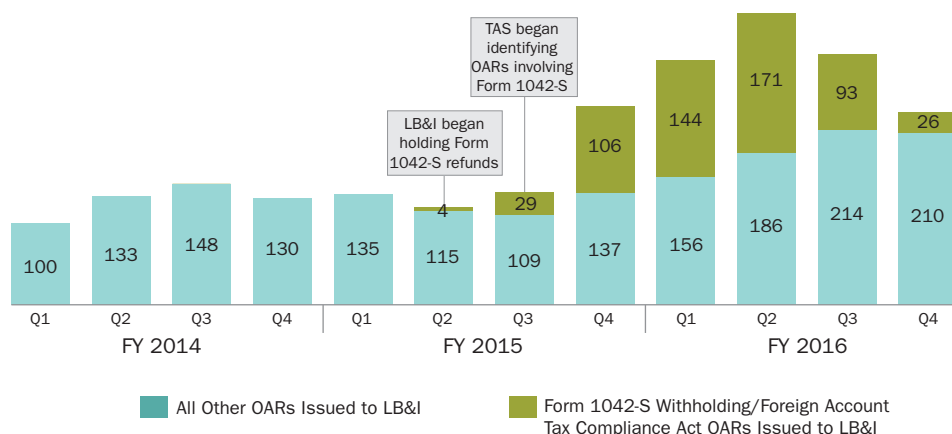
92 IRS CDW IMF Transaction History table, IRTF Form 1040 table, TYs 2013–2014, cycle posted 201608. In Aug. 2016, TAS evaluated CDW data on the 36,842 taxpayers that received a 2014 Form 1042-S from payers that used the same software to provide the length of time the taxpayers had to wait and the dollar amounts of their refunds.

93 Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

withholding verification, it opened a control on its Audit Information Management System (AIMS). LB&I assured TAS that using AIMS to control the OARs would not increase the scrutiny these returns would undergo. LB&I added significantly to the time it needed to work these OARs by opening the AIMS controls. LB&I took 42 days on average to complete the actions TAS requested via OARs for the Form 1042-S withholding cases.

**FIGURE 4.1.12**<sup>94</sup>

**Operations Assistance Requests (OARs) Issued to Large Business & International (LB&I) Division, FYs 2014-2016 by Quarter**



***TAS Taxpayers Had a Higher Rate of Audit Selection***

TAS identified taxpayers who filed TY 2013 or 2014 Forms 1040-NR or Forms 1040-NR-EZ, *U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents*, claiming refunds from Form 1042-S withholding.<sup>95</sup> TAS segmented this group by determining whether TAS assisted the taxpayer by sending an OAR to LB&I related to Form 1042-S withholding verification, and whether LB&I audited the taxpayer.<sup>96</sup> TAS found the IRS audited three percent of the non-TAS taxpayers, and 19 percent of the TAS taxpayers.<sup>97</sup> TAS gave the data and results to LB&I. LB&I immediately stopped gathering information that it did not need to perform withholding verification, but used to put the tax returns on AIMS. TAS received 774 FATCA withholding cases in FY 2016, including about 42 percent with economic burden.<sup>98</sup> In FY 2016, TAS obtained relief for over 81 percent of taxpayers in FATCA withholding cases.<sup>99</sup> TAS's average time to conclude a FATCA withholding case in FY 2016

<sup>94</sup> Data obtained from TAMIS (2014; 2015; 2016; data obtained on the date following the month ending).

<sup>95</sup> See National Taxpayer Advocate FY 2016 Objectives Report 48-52 (Area of Focus: *The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*, Figure 3.4.1 - Noncompliance Rates for Form 8938 Filers vs. General Population Taxpayers).

<sup>96</sup> TAS counted the taxpayer as audited if the status code on AIMS indicated the return had advanced to or past the point where an audit started.

<sup>97</sup> IRS CDW, IMF Transaction History table, IRTF Form 1040 table, TYs 2013-2014, cycle posted 201608. 1,784 audited of 63,317 non-TAS taxpayers (three percent). Sixty-seven audited of 351 TAS taxpayers (19 percent). Data obtained from TAMIS (Apr. 30, 2016).

<sup>98</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>99</sup> *Id.*



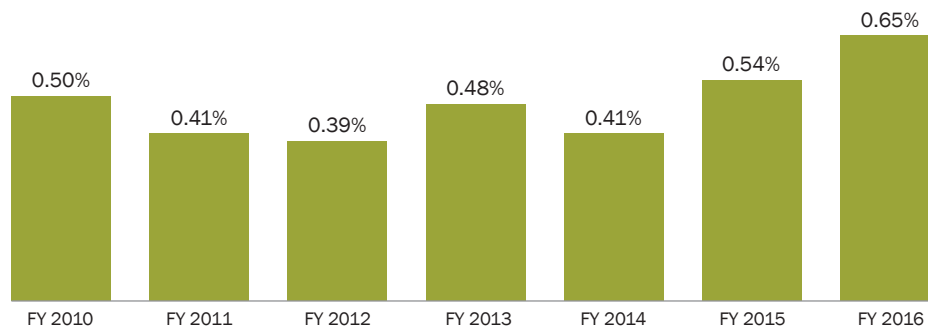
of about 89 days is significantly less than the IRS's published time of 168 days, or the extended time of 12 months.<sup>100</sup>

### Collection Cases

Though collection issues are not in the top five of economic burden case receipts, taxpayers face severe consequences when the IRS enforces collection by levies on income or other assets, liens on property, or seizure of property. TAS received 19,043 collection issue cases in FY 2016, a decrease of nearly 14 percent from FY 2015.<sup>101</sup> The IRS's use of levies and liens declined during these periods.<sup>102</sup> However, liens and levies account for about 46 percent of TAS's contact from taxpayers with collection issues in FY 2016, with nearly 83 percent of the lien and levy cases involving economic burden.<sup>103</sup>

**FIGURE 4.1.13**<sup>104</sup>

**TAS Levy Cases as Percentage of IRS Levies Issued, FYs 2010-2016**



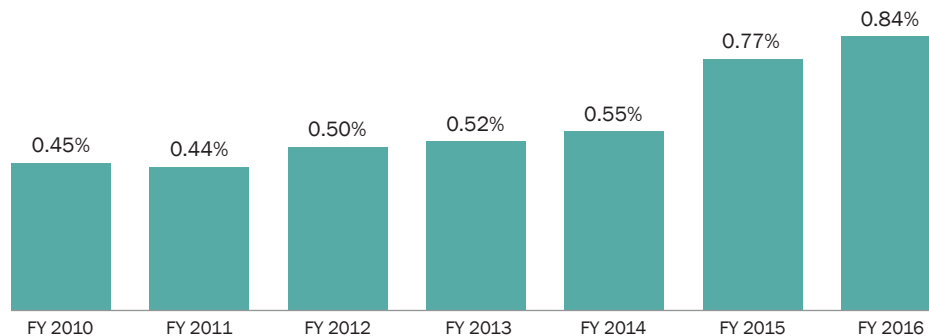
<sup>100</sup> IRM 21.8.1.11.14.2, *FATCA — Programming Beginning January 2015 Affecting Certain Forms 1040-NR (TC 810-3-E Freeze)* (May 1, 2015) (August 1, 2016). See also IRS SERP Alert 15A0188 (Mar. 23, 2015).

<sup>101</sup> Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

<sup>102</sup> See National Taxpayer Advocate 2015 Annual Report to Congress 100-22. In FY 2014, TAS's case receipts for all collection PCICs were 21,936. In FY 2015, they were 22,084, an increase of less than one percent. In FY 2016, they were 19,043. From FY 2010 to FY 2016, levies issued by the IRS decreased by about 76 percent and lien filings decreased 67 percent. IRS, Collection Activity Reports, NO-5000-24, *Levy and Seizure Report* (FYs 2010 to 2016); IRS, Collection Activity Reports, NO-5000-25, *Liens Report* (FYs 2010 to 2016).

<sup>103</sup> Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016). In FY 2015, TAS received 7,977 levy cases and 3,051 lien cases for a total of 11,028 cases, or 49.9 percent of the total collection cases. Of the 11,028 cases, 7,074 levy cases and 2,372 lien cases were economic burden, or 85.7 percent. In FY 2016, TAS received 5,626 levy cases and 3,072 lien cases for a total of 8,698 cases, or 45.7 percent of the total collection cases. Of the 8,698 cases, 4,850 levy cases and 2,377 lien cases were economic burden, or 83.1 percent.

<sup>104</sup> Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016). IRS, 5000-23 Collection Workload Indicators (Mar. 22, 2011; Oct. 11, 2011); IRS, 5000-25 Collection Activity Report (Oct. 1, 2012; Sept. 30, 2013; Sept. 29, 2014; Oct. 9, 2015; Oct. 19, 2016).

**FIGURE 4.1.14**<sup>105</sup>**TAS Lien Cases as Percentage of IRS Liens Issued, FYs 2010-2016**

Despite a decline in the number of liens or levies being issued, as shown in Figures 4.1.13 and 4.1.14, taxpayers seeking TAS assistance with liens and levies issues increased from FY 2010 to FY 2016. The IRS is actually causing more harm to taxpayers while issuing fewer liens and levies. The National Taxpayer Advocate is concerned about whether the taxpayers' rights to privacy and to a fair and just tax system are being protected.

TAS provided relief in about 71 percent of collection cases in FY 2016, compared to approximately 78 percent on all issues.<sup>106</sup> In FY 2016, TAS issued 46 Taxpayer Assistance Orders (TAOs) in collection cases where the IRS did not agree with TAS's recommendations initially.<sup>107</sup> Of these 46 TAOs, the IRS complied with 30 in an average of 25 days, meaning the IRS's negative responses to TAS's requests unnecessarily delayed resolution, further harming the taxpayers, when there was no material disagreement on the resolution.<sup>108</sup>

In FY 2016, TAS focused on the harm done by retirement account levies.<sup>109</sup> The examples presented in this report illustrate issues raised in cases handled by TAS. To comply with IRC § 6103, which generally requires the IRS to keep taxpayers' returns and return information confidential, the details of the fact patterns have been modified or redacted. In certain examples, TAS has obtained the written consent of the taxpayer to provide more detailed facts.

<sup>105</sup> Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016). IRS, 5000-23 Collection Workload Indicators (Mar. 22, 2011; Oct. 11, 2011); IRS, 5000-24 Collection Activity Report (Oct. 9, 2012; Oct. 22, 2013); IRS, 5000-25 Collection Activity Report (Oct. 6, 2014; Oct. 7, 2015; Oct. 19, 2016). IRS liens may be placed on an account in one year but become a TAS case in a different year. For purposes of this chart, TAS divided the number of lien cases received by TAS in the given fiscal year by the number of liens issued by the IRS for the same fiscal year.

<sup>106</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>107</sup> TAO compliance data is as of Oct. 1, 2016.

<sup>108</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>109</sup> See National Taxpayer Advocate FY 2017 Objectives Report to Congress 94-101 (Area of Focus: *Despite Insufficient Internal Guidance, the IRS Continues to Levy on Retirement Accounts and Has Completed a Pilot for Levying on Thrift Savings Plan Accounts Through the Automated Collection System*).

The IRS assessed a Trust Fund Recovery Penalty (TFRP) against a taxpayer.<sup>110</sup> An IRS employee previously declined to issue a levy, because the taxpayer was near retirement age and would rely on the funds in retirement, placing the taxpayer in currently not collectible (CNC) status.<sup>111</sup> Within 30 days of expiration of the Collection Statute Expiration Date (CSED),<sup>112</sup> the IRS issued a levy to seize the entire retirement account. The taxpayer sought TAS's assistance. After a detailed analysis of his financial information, including the poverty level and mortality rate calculation of funds needed for his anticipated life span, TAS determined the taxpayer still met the CNC requirements. TAS deemed that the taxpayer would depend on these retirement funds and did not find any "flagrant" conduct warranting this levy.<sup>113</sup> The IRS acted solely due to the imminent CSED. TAS found that the IRS did not offer the taxpayer his right to an appeal, which is contrary to a taxpayer's *right to appeal an IRS decision in an independent forum*.<sup>114</sup> Because minimal time remained before the financial institution released the levied funds, TAS issued an OAR to stop the release of funds pending review by TAS.<sup>115</sup> The IRS responded that the levy was procedurally correct without addressing hardship or the taxpayer's future dependence on the retirement account. TAS issued a TAO.<sup>116</sup> TAS noted that the law requires a levy release when the levy would create an economic hardship for the taxpayer.<sup>117</sup> The IRS then granted the hold of the levied funds. TAS proved the hardship and demonstrated the flaws in the IRS's financial analysis. The IRS agreed not to levy on the retirement account.

In another case, the taxpayer's wife received a wage levy after the taxpayer incurred a tax debt as the result of withdrawing funds from her retirement account without adequately withholding for income taxes on the withdrawal.<sup>118</sup> The taxpayers needed the funds to pay basic living expenses when taxpayer's husband lost his job. The IRS released the levy in response to an OAR. TAS learned that the taxpayers were divorcing and that taxpayer wife lost her job. The IRS still denied CNC, implying the IRS would levy the remaining balance in her retirement account, restating that the taxpayer's failure to have withholding caused the debt. The IRS did not complete the analysis required per its own guidance before it issued a levy on the retirement account. TAS issued a TAO to assure that the IRS properly considered the taxpayer's current situation, including job loss, age, and reliance on the retirement account in the near future, and again requested CNC treatment. By law, the IRS must release a levy on the property of a

110 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Aug. 11, 2016. IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. The IRS refers to these taxes as "trust fund" taxes. Trust fund taxes include employment taxes, income tax withheld from employees' wages, and certain types of excise taxes. IRC § 6672 provides for the assessment of a Trust Fund Recovery Penalty (TFRP) against those deemed responsible persons when these monies are not paid as required. For a discussion of litigated TFRP cases see Most Litigated Issue: *Trust Fund Recovery Penalty (TFRP) Under Internal Revenue Code § 6672*, *supra*.

111 When a taxpayer has no assets or income, which are, by law, subject to levy, or it is determined that levy action would create a hardship, the IRS may report the liability as currently not collectible. A hardship exists if the levy action prevents the taxpayer from meeting necessary living expenses. IRM 1.2.14.1.14, *Policy Statement 5-71* (Nov. 19, 1980). See also Treas. Reg. 301.6343-1(b)(4).

112 IRC § 6502.

113 See National Taxpayer Advocate 2015 Annual Report to Congress 100-11 (Most Serious Problem: *Levies on Assets in Retirement Accounts: Current IRS Guidance Regarding Levies on Retirement Accounts Does Not Adequately Protect Taxpayer Rights and Conflicts with Retirement Security Public Policy*).

114 See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

115 See *TAS Operations Assistance Request Trends*, *infra*.

116 For a detailed discussion of TAOs, see *TAS Uses Taxpayer Assistance Orders to Advocate Effectively in Taxpayer Cases*, *infra*.

117 IRC § 6343(a)(1)(D).

118 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Aug. 16, 2016.

taxpayer if the levy is creating an economic hardship due to the financial condition of the taxpayer.<sup>119</sup> The IRS agreed not to pursue the levy because the additional income tax generated from a levy on the retirement account would create an economic hardship for the taxpayer and placed the taxpayer's account into CNC status.

### TAS Operations Assistance Request (OAR) Trends

To assist taxpayers more efficiently, the Commissioner of Internal Revenue delegated to the National Taxpayer Advocate certain tax administration authorities that do not conflict with or undermine TAS's unique statutory mission, but allow TAS to resolve routine problems.<sup>120</sup> When TAS lacks the statutory or delegated authority to resolve a taxpayer's problem, it works with the responsible IRS BOD or function to resolve the issue, a process necessary in 67 percent of all TAS cases closed in FY 2014, 69 percent in FY 2015, and 68 percent in FY 2016.<sup>121</sup> After independently reviewing the facts and circumstances of a case and communicating with the taxpayer, TAS issues OARs to convey a recommendation or request that the IRS take action to resolve the issue, and provides documentation that supports it. The OAR also serves as an advocacy tool by:

- Giving the IRS a second chance to resolve the issue;
- Giving TAS and the BOD a chance to resolve the issue without having to elevate it; and
- Documenting systemic trends that could lead to improvements in IRS processes.

All BODs agree to work TAS cases on a priority basis and expedite the process for taxpayers whose circumstances warrant immediate handling. The Service Level Agreements (SLAs) require the BODs to direct resources to process OARs.<sup>122</sup> The OAR report alerts the BODs to the number of taxpayers who seek TAS assistance, because they have not been able to resolve their problems through regular channels within the BODs' control and the types of issues. Form 12412, *Operations Assistance Request*, includes an "expedite" box that TAS case advocates may check when the BOD needs to act immediately to relieve the taxpayer's significant hardship.

TAS generally sends one or more OARs on individual cases to secure action by the IRS, but TAS may use a single OAR to work the same issue for multiple taxpayers, which TAS calls a "bulk OAR." During the 2016 filing season, TAS successfully implemented a bulk OAR process for cases involving Integrity and Verification Operations (IVO) Pre-Refund Wage Verification Holds. TAS and IVO used the new process for 16 weeks during the 2016 filing season and agreed to expand this process through December 31, 2016. Over 26 weeks, TAS sent 360 accounts to IVO on Bulk OARs. IVO quickly reviewed and took action to release refunds to taxpayers in two business days or less.<sup>123</sup> TAS and IVO will revisit and update the procedures for the 2017 filing season.

119 IRC § 6343(a)(1)(D). Economic hardship exists when an individual taxpayer is unable to pay his or her reasonable basic living expenses. Treas. Reg. § 301.6343-1(b)(4)(i).

120 IRM 1.2.50.3(1), *Delegation Order 13-2 (Rev. 1)* (Mar. 3, 2008) Authority of the National Taxpayer Advocate to Perform Certain Tax Administration Functions.

121 TAS closed 149,484 cases with OARs in FY 2014; 156,273 in FY 2015; 149,739 in FY 2016. TAS can issue more than one OAR on a case. Data obtained from TAMIS (Oct. 6, 2014; Oct. 5, 2016; Oct. 3, 2016).

122 TAS has a Service Level Agreement (SLA) with each business operating division (BOD). Each SLA states the terms of engagement between TAS and the BODs, as agreed to by their respective executives, including timeframes and processes for communication in the OAR and TAO processes to assure that the IRS treats TAS cases with the agreed upon level of priority.

123 Data obtained from TAMIS (Oct. 1, 2016).

**FIGURE 4.1.15, Expedited and Non-Expedited OARs Issued by BOD, FY 2016**<sup>124</sup>

| Business Operating Division      | FY 2016 OARs Issued Requesting Expedite Action | FY 2016 OARs Issued Without Expedite Request | FY 2016 Total OARs Issued |
|----------------------------------|--|--|---------------------------|
| Appeals                          | 260  | 555  | 815                       |
| Criminal Investigation           | 31   | 64   | 95                        |
| Large Business and International | 343  | 841  | 1,184                     |
| Small Business/Self-Employed     | 20,561   | 26,169                                       | 46,730                    |
| Tax Exempt/Government Entities   | 264  | 400  | 664                       |
| Wage and Investment              | 97,425   | 90,451                                       | 187,876                   |
| <b>Total</b>                     | <b>118,884</b>                                 | <b>118,480</b>                               | <b>237,364</b>            |

As depicted in Figure 4.1.15, TAS issues OARs across all IRS Business Operating Divisions and Functions. As described in previous Objectives Reports to Congress, TAS worked with the IRS Information Technology function and contractors to develop a replacement system known as the Taxpayer Advocate Service Integrated System (TASIS) that included functionality to electronically submit and track OARs.<sup>125</sup> The IRS halted TASIS development within an estimated six months of its completion in March 2014 due to budget constraints. Subsequently, the IRS launched a comprehensive project to create a servicewide Enterprise Case Management (ECM) solution. The ECM model would provide automation for OARs. However, at the time of this report, ECM planning has dropped electronic OARs from implementation plans through FY 2018.<sup>126</sup>

### TAS Uses Taxpayer Assistance Orders (TAOs) to Advocate Effectively

The TAO is a powerful statutory tool, delegated by the National Taxpayer Advocate to Local Taxpayer Advocates (LTAs), to resolve taxpayer cases.<sup>127</sup> LTAs issue TAOs to order the IRS to take certain actions, cease certain actions, or refrain from taking certain actions.<sup>128</sup> A TAO may also order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level.<sup>129</sup> If a taxpayer faces significant hardship and the facts and law support relief, an LTA may issue a TAO when the IRS refuses or otherwise fails to take the action TAS has requested to resolve the case.<sup>130</sup> Once TAS issues a TAO, the BOD must comply with the request or appeal the issue for resolution at higher management levels.<sup>131</sup> Only the National Taxpayer Advocate, Commissioner, or Deputy

<sup>124</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>125</sup> For more information, see Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*, *supra*; National Taxpayer Advocate 2017 Objectives Report to Congress 195-97 (TAS Technology: *TAS Focus on IRS Enterprise Case Management (ECM) and the Taxpayer Advocate Integrated System (TASIS)*); National Taxpayer Advocate 2016 Objectives Report to Congress 90-105 (TAS Technology: *TAS Remains Steadfast in the Search for Funding to Modernize Antiquated Systems*); and National Taxpayer Advocate 2015 Objectives Report to Congress 92-98 (Area of Focus: *IRS Funding Gap Creates Severe Risk to the Delivery of the Taxpayer Advocate Service Integrated System (TASIS)*).

<sup>126</sup> For more information, see Most Serious Problem: *Enterprise Case Management: The IRS's Enterprise Case Management Strategy Fails to Capitalize on TAS's Prior Case Management Efforts and Has the Potential for Waste and Duplication*, *supra*.

<sup>127</sup> IRC § 7811(f) states that for purposes of this section, the term "National Taxpayer Advocate" includes any designee of the National Taxpayer Advocate. See IRM 1.2.50.2, *Delegation Order 13-1* (Rev. 1) (Mar. 17, 2009).

<sup>128</sup> IRC § 7811(b); Treas. Reg. § 301.7811-1(c)(3); IRM 13.1.20.3, *Purpose of Taxpayer Assistance Orders* (Dec. 15, 2007).

<sup>129</sup> Treas. Reg. § 301.7811-1(c)(3); IRM 13.1.20.3 (Dec. 15, 2007).

<sup>130</sup> IRC § 7811(a)(1); Treas. Reg. § 301.7811-1(a)(1) and (c).

<sup>131</sup> IRM 13.1.20.5(2), *TAO Appeal Process* (Dec. 9, 2015).

Commissioner may rescind a TAO, and until a TAO is rescinded, the Operating Division cannot take action on the case.<sup>132</sup>

In FY 2016, TAS issued 144 TAOs,<sup>133</sup> including 13 in cases where the IRS failed to respond to an OAR, further delaying relief to taxpayers. Of these 13 TAOs, the IRS complied with eight TAOs in an average of 21 days, meaning the IRS did not have a significant disagreement as to the resolution and the taxpayers could have had relief sooner if the IRS had been more responsive to TAS.<sup>134</sup> Figure 4.1.16 reflects the results of all TAOs. Figure 4.1.17 shows the TAOs issued by fiscal year.

**FIGURE 4.1.16, Actions Taken on FY 2016 TAOs Issued**<sup>135</sup>

| Action                                  | Total      |
|---|------------|
| IRS Complied With the TAO               | 92         |
| IRS Complied After the TAO Was Modified | 2          |
| TAS Rescinded the TAO                   | 14         |
| TAO Pending in Process or on Appeal     | 36         |
| <b>Total</b>                            | <b>144</b> |

**FIGURE 4.1.17, TAOs Issued to the IRS, FYs 2012–2016**<sup>136</sup>

| Fiscal Year | TAOs Issued |
|-------------|-------------|
| 2012        | 434         |
| 2013        | 353         |
| 2014        | 362         |
| 2015        | 236         |
| 2016        | 144         |

In January 2016, the IRS finally issued updated guidance, stating the circumstances in which qualifying taxpayers would be entitled to relief from the actions of unscrupulous return preparers and how to adjust taxpayer accounts. Since FY 2010, TAS issued 174 Return Preparer Misconduct (RPM) TAOs, including 13 issued in FY 2016 before the National Taxpayer Advocate issued guidance for TAS employees to implement the IRS guidance on the outstanding TAO cases.<sup>137</sup>

TAS modified the TAOs per the new guidance to seek relief for the taxpayers. To date, the IRS complied with 78 of the modified TAOs by processing the taxpayers' corrected returns, eliminating any balances

<sup>132</sup> IRC § 7811(c)(1) and Treas. Reg. § 301.7811-1(b).

<sup>133</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

<sup>137</sup> See *Interim Guidance on Advocating for Taxpayers Impacted by Return Preparer Misconduct*, TAS-13-0916-007 (Sept. 5, 2016); *Interim Guidance on Allegations of Return Preparer Misconduct for the Identity Theft Victim Assistance – Compliance (IDTVA-C) Only for Tax Year 2013 and Prior (Suspended Cases Only)*, WI-25-1215-003 (Dec. 31, 2015); *Interim Guidance on Allegations of Return Preparer Misconduct for IDTVA RPM Accounts Management (AM) ONLY for Cases Tax Year 2013 (and prior) Received On or Before 12/31/2015*, WI-25-1215-004 (Dec. 31, 2015). Data obtained from TAMIS (Oct. 1, 2016).



caused by the preparers' actions, and releasing refunds to the taxpayers.<sup>138</sup> The IRS is still considering 38 of the modified TAOs.<sup>139</sup> TAS is actively developing 11 cases to meet the IRS's requirements.<sup>140</sup> TAS may elevate the modified TAOs, if TAS and the BOD do not reach agreement. TAS rescinded 39 of the TAOs without relief for the taxpayers, because the taxpayers were unable to secure the information that the IRS required in its new procedures.<sup>141</sup> The taxpayers were hampered by the extensive time lapse between the National Taxpayer Advocate's elevation of this issue in 2011, subsequent debate with the IRS over the ensuing five years, and the IRS's final release of guidance. For example, taxpayers were unable to file police reports with local law enforcement agencies, because the incidents occurred more than three years ago. Others were not able to locate flyers, business cards, website pages, etc., to show that the individual presented himself as a preparer of returns at the time.

In FY 2016, TAS held discussions on the TAO process, and the use of TAOs during leadership calls, emphasizing all facets of advocacy and to strengthen awareness of situations needing a TAO. For example, TAS disseminated information in these calls about modifying the suspended RPM TAOs to secure final relief for qualifying taxpayers under the IRS's Interim Guidance Memorandum (IGM) and updated IRM procedures after the taxpayers patiently waited for years.<sup>142</sup>

The following examples illustrate the use of TAOs to obtain taxpayer relief.

#### TAXPAYER ASSISTANCE ORDERS (TAOs) INVOLVING ACCOUNT RESOLUTION

As discussed above, ID Theft can adversely affect taxpayers. Approximately 74 percent of individual taxpayers filing returns claimed refunds, averaging about \$2,746.<sup>143</sup> In an ID Theft situation, where the IRS processed a false return before the actual taxpayer filed a return, the IRS will not issue a refund to the actual taxpayer until the IRS fully resolves the Social Security number ownership, which can take 180 days.<sup>144</sup> In FY 2016, TAS issued five TAOs involving ID theft.<sup>145</sup> The IRS complied with three of these TAOs; two are in process.<sup>146</sup> The taxpayers faced economic burden in three of these cases and thus needed expedited case handling.<sup>147</sup> Specific examples of hardships encountered by these taxpayers and exacerbated by IRS delays included:

- Taxpayer was being evicted;
- Taxpayer needed to pay rent and utilities; and
- Taxpayer was behind on bills and needed to repair his car to get to work.

<sup>138</sup> Data obtained from TAMIS (Nov. 29, 2016).

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> See *Interim Guidance on Advocating for Taxpayers Impacted by Return Preparer Misconduct*, TAS-13-0916-007 (Sept. 5, 2016); *Interim Guidance on Allegations of Return Preparer Misconduct for the Identity Theft Victim Assistance – Compliance (IDTVA-C) Only for Tax Year 2013 and Prior (Suspended Cases Only)*, WI-25-1215-003 (Dec. 31, 2015); *Interim Guidance on Allegations of Return Preparer Misconduct for IDTVA RPM Accounts Management (AM) ONLY for Cases Tax Year 2013 (and prior) Received On or Before 12/31/2015*, WI-25-1215-004 (Dec. 31, 2015).

<sup>143</sup> IRS, 2015 SP Program Management, *Process Assurance Branch Filing Season Statistics Report*, Week Ending Aug. 20, 2016. Through Aug. 19, 2016, the IRS received 145,151 million individual tax returns, of which 107,696 million claimed a refund averaging \$2,746.

<sup>144</sup> IRM 25.23.3.2.2(1)(f), *Tax-Related Identity Theft* (Oct. 1, 2016).

<sup>145</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>146</sup> *Id.*

<sup>147</sup> Data obtained from TAMIS (Oct. 1, 2015).

Examples of TAOs involving account resolution issues follow:

The taxpayer submitted his return with his correct bank account number for a direct deposit refund but never received his refund. Because the taxpayer filed the return with the correct account information, TAS requested that the IRS issue the taxpayer his refund. The IRS claimed it input the information from the taxpayer's return and the error was the taxpayer's.<sup>148</sup> TAS challenged this. The IRS provided an exact copy of the taxpayer's return, which contained a different direct deposit account than on the copy the taxpayer kept for his records. TAS confirmed that the account owner, not the taxpayer, withdrew the funds, so the bank could not return the funds to the IRS. TAS contacted the Treasury Inspector General for Tax Administration (TIGTA). Based on its investigation, TIGTA confirmed the return was altered after the IRS received it, which TIGTA pursued separately. TIGTA agreed the IRS should make the taxpayer whole. The IRS continued to refuse to release the refund. TAS issued a TAO to secure the refund. The IRS released the refund.<sup>149</sup>

In another case, the taxpayer filed an injured spouse claim.<sup>150</sup> The IRS mailed the refund to the wrong address. When the refund was re-issued, the injured spouse coding was not re-input, so the refund offset against the debt of the spouse again. TAS had the refund returned from the other agency to the taxpayers' account and issued the refund a third time, but the check never arrived. TAS performed a refund trace and issued an OAR to re-issue the check after the postal service returned the check and the IRS posted the funds back to the account. The IRS did not respond to the OAR. When TAS followed up, the IRS said it was too busy with filing season phone duty. The IRS refused to work the case without a TAO, so TAS obliged.<sup>151</sup> The IRS released the refund.<sup>152</sup>

The taxpayer filed original income tax returns to correct his accounts after the IRS made substitute for return assessments (SFR).<sup>153</sup> The taxpayer stated that he would not actually owe any tax once the IRS processed the original returns. TAS wanted the IRS to cease collection action and process the returns. The IRS did not acknowledge receipt of one return and sent the other for statute clearance.<sup>154</sup> The IRS then said the SFR Unit had to address the problem. The IRS refused to engage in discussion at the next

148 IRM 21.4.1.4.7.5, *Non-Receipt of Direct Deposited Refunds — "Refund Inquiry Employees"* (Oct. 1, 2016 and Dec. 7, 2016).

149 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Aug. 1, 2016.

150 IRC § 6402. When a married couple files a joint return claiming a refund, the IRS may offset the refund to satisfy certain outstanding tax and non-tax debts belonging to one of the spouses. The non-liable spouse has a right to have a portion of the refund returned. Form 8379, *Injured Spouse Allocation*, is the form the non-liable spouse uses to claim his or her share of the refund.

151 TAS received this response repetitively from one unit on multiple cases, resulting in TAS issuing multiple TAOs. TAS elevated the situation to the Filing Season Readiness team for resolution to avoid further delays for additional taxpayers. The unit resumed working OARs promptly.

152 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Jul. 28, 2016.

153 A substitute for return (SFR) is a return prepared for a taxpayer by the IRS when it has no record of receiving a return and has not been able to obtain one from someone whom the IRS expected to file. IRC § 6020(b) allows the IRS to prepare a return on behalf of the taxpayer based on available information. The taxpayer may reduce the SFR liability by filing an original return, reflecting allowable deductions and credits about which the IRS had no information at the time the SFR was prepared.

154 IRM 25.6.1.2, *What Is a Statute of Limitation* (Oct. 1, 2001) states that "A statute of limitation is a time period established by law to review, analyze and resolve taxpayer and/or IRS tax related issues." The statute function reviews a return to assure that the IRS may process it, because the statute of limitations has not expired, which is called "clearance."

level, as required by the SLA.<sup>155</sup> TAS issued a TAO to each unit with which problems were occurring. The IRS promptly posted the returns, reversed the prior offsets of subsequent year refunds, and released the refunds, because the taxpayer did not owe a balance after the IRS took these actions.<sup>156</sup>

A taxpayer came to TAS after waiting 30 weeks for the IRS to process his amended returns for two tax years, regarding Form 4361, *Application for Exemption from Self-Employment Tax for a Minister*. The normal processing time for amended returns is 16 weeks.<sup>157</sup> The normal processing time for the Form 4361 is 45 days.<sup>158</sup> TAS sent an OAR. The IRS did not acknowledge the OAR, or take other actions due to filing season phone duty. TAS issued a TAO. The IRS sent the refund to the wrong address, causing additional delay. The IRS placed a hold on the account.<sup>159</sup> TAS had the hold removed, as it was incorrect. The IRS released the refund.<sup>160</sup>

Another taxpayer received an adjustment to his veteran's benefits due to exposure to Agent Orange. He filed a Form 1040-X, *Amended Individual Income Tax Return*, claiming an additional refund due to the tax-exempt nature of the payments. The IRS denied his request, saying the taxpayer filed after the refund statute expired, ignoring the specific extended statute of limitations period allowed for this issue.<sup>161</sup> He received a Letter 105C, *Notice of Claim Disallowance*, to allow appeal rights. The IRS and Appeals said he did not make a timely appeals request. TAS disagreed with the IRS's and Appeals' determinations on the technical merits of the amended return and the taxpayer's timeliness to appeal. TAS secured a Form 843, *Claim for Refund*, to secure new appeal rights for the taxpayer. TAS sent an OAR with a full explanation about why the claim was allowable in full. Accounts Management (AM) allowed the claim and entered the adjustments. AM sent the Form 843 to the statute function of the IRS, as required, to review it to assure that the statute of limitations had not expired. The statute function ignored the exception to the statute of limitations for this issue and refused to release the hold on the account, preventing issue of the refund. The IRS would not issue a second Letter 105C, to allow appeal rights, again stating the taxpayer already received one and missed the date to appeal. TAS issued a TAO to pursue the release of the refund as allowed by AM, asserting that the statute function did not have the authority to override AM's

155 TAS has an SLA with each business operating division (BOD). Each SLA states: "The signatures of the NTA and the Commissioner, BOD reflect concurrence that TAS casework requires priority consideration and will receive that consideration within" the respective BOD. Later, the SLAs state: "If the BOD employee assigned to the OAR and the TAS employee cannot agree upon the appropriate resolution of the taxpayer's problem, the TAS employee and BOD employee will elevate this disagreement to their immediate managers. If an agreement on the appropriate resolution cannot be reached within three (3) workdays, the managers will elevate the issue through the appropriate management channels within TAS and the BOD for resolution or consideration of a Taxpayer Assistance Order by the LTA." The National Taxpayer Advocate's intent with this language is to reach expeditious resolutions to avoid further harm to the taxpayers.

156 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by taxpayer dated Jul. 31, 2016.

157 IRM 21.4.1.3(2), *Refund Inquiry Response Procedures* (Oct. 1, 2016).

158 IRM 3.30.123.15.2, Form 4361, *Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners*, and Form 4029, *Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits (Philadelphia Campus Only) Processing Specifications* (Jan. 1, 2014).

159 IRM 21.5.6.1(1), *Freeze Codes Overview* (Oct. 1, 2016) states that "Freeze conditions prevent the issuance of refunds, credit offsets, or the assessment of accrued interest and/or penalties." Some freeze codes prevent all action on an account until the cause of the freeze is resolved, while others indicate that research is needed prior to taking any action.

160 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Aug. 21, 2016.

161 IRC § 6511(a) states the general rule that no credit or refund shall be allowed or made more than three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within two years from the time the tax was paid. However, Congress created an exception to the general rule for refund claims relating to disability determinations by the Department of Veterans Affairs. See IRC § 6511(D) and IRM 21.6.6.3.20.1, *Extension of the Statute of Limitations to File Claims for Refund Relating to Disability Determinations by the Department of Veterans Affairs (Section 106 of Public Law 110-245)* (Jul. 5, 2016).

technical decision and that the statute function erred in its decision that the claim was not filed timely. In the alternative, TAS wanted the Letter 105C issued based on the Form 843, not reliance on the prior Letter 105C from the Form 1040-X. The IRS released the \$450 refund with \$140.66 of interest. The IRS and TAS expended resources well in excess of this amount with interest accruing daily, while the IRS was technically and procedurally incorrect, and harmed a disabled veteran.<sup>162</sup>

#### **TAXPAYER ASSISTANCE ORDERS (TAOs) TO EXAMINATION FUNCTIONS**

In FY 2016, TAS issued 18 TAOs to examination units in W&I, Small Business/Self-Employed (SB/SE), and LB&I BODs for issues including return preparer misconduct, the EITC, audit reconsiderations, actions to complete open audits of original returns, penalty abatements, and appeal rights.<sup>163</sup> For example:

A taxpayer came to TAS after the IRS denied his request for an audit reconsideration, citing the inability to locate the prior audit file. TAS secured the file and the taxpayer's documents. The IRS sent the file to an examination group. Once the IRS assigned the case, the examiner told the taxpayer that she would not work the case for at least six months, contrary to the SLA with TAS. TAS attempted discussion with the examination manager, who did not respond to any form of contact. The IRS requested a statute extension before they would proceed, which was unnecessary, because the tax was already assessed. TAS issued a TAO directing the IRS to follow the Internal Revenue Code, the IRM, and the SLA to complete the audit reconsideration process after the IRS's inactivity continued and it failed to respond to TAS's contacts. The IRS issued an audit report to the taxpayer, abating the prior assessments.<sup>164</sup>

#### **TAXPAYER ASSISTANCE ORDERS (TAOs) TO TAX EXEMPT/GOVERNMENT ENTITIES (TE/GE)**

TE/GE cases present vitally important advocacy opportunities for TAS, both on substantive legal determinations and processing issues.<sup>165</sup> Tax-exempt organizations (EOs) contribute religious, educational, scientific, social welfare, and other positive benefits to the public. Many of these EOs are small entities, staffed by volunteers.<sup>166</sup> Without the IRS's determination on the tax exemption, the entity will struggle to solicit funds from donors, who are motivated in part by the ability to deduct contributions made to an approved IRC § 501(c)(3) tax-exempt entity. While some EOs under IRC § 501(c) may operate without the need to seek an IRS determination, it is TAS's experience with IRC § 501(c) cases that many entities are reluctant to operate without formal IRS approval.<sup>167</sup>

<sup>162</sup> In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Aug. 4, 2016.

<sup>163</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>164</sup> In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer's case. Release signed by the taxpayer dated Jul. 30, 2016.

<sup>165</sup> See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013); National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (Jun. 30, 2013).

<sup>166</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 287, addressing the need for targeted research and increased collaboration to meet the needs of tax Exempt Organizations (EOs); National Taxpayer Advocate 2005 Annual Report to Congress 293, discussing inadequate service to EOs resulting in unnecessary penalties; National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (Jun. 30, 2013).

<sup>167</sup> Some organizations are not required to obtain formal recognition of tax-exempt status from the IRS but may obtain such recognition by submitting IRS Form 1024, *Application for Recognition of Exemption Under Section 501(a)*. National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* 3 (June 30, 2013), [www.taxpayeradvocate.irs.gov/2014ObjectivesReport/Special-Report](http://www.taxpayeradvocate.irs.gov/2014ObjectivesReport/Special-Report).

In FY 2016, TAS did not issue any TAOs to the TE/GE BOD.<sup>168</sup> TAS's FY 2016 case receipts involving applications for exempt status decreased by about 48 percent from FY 2015.<sup>169</sup> Over 34 percent of the FY 2016 cases met economic burden criteria, and nearly 71 percent were congressional referrals.<sup>170</sup> The decline in EO cases may be attributed to the introduction of the abbreviated Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. Taxpayers have received the IRC § 501(c)(3) exemption approval more quickly, causing fewer to seek TAS's assistance. However, while this expedited process for obtaining tax exempt status has reduced TAS EO casework, it has created a significant compliance concern.<sup>171</sup> Overall, TAS provided some form of relief in nearly 81 percent of cases (549 organizations) seeking to resolve exempt status application issues in FY 2016.<sup>172</sup> TAS resolved these cases in an average of 75 days.<sup>173</sup>

#### TAXPAYER ASSISTANCE ORDERS (TAOs) ON COLLECTION ISSUES

TAS issued 17 TAOs on levy cases in FY 2016.<sup>174</sup> The IRS complied with 12 of the 17 TAOs for levies in FY 2016.<sup>175</sup> Eight of the 17 levy-related TAOs requested the return of levy proceeds for taxpayers experiencing economic burden.<sup>176</sup> TAS rescinded one and is processing four more.<sup>177</sup>

TAS issued 29 TAOs to Collection functions for non-levy issues:<sup>178</sup>

In one case, the taxpayer received back-up withholding (BWH) notices despite having reported all income.<sup>179</sup> TAS requested reversal of the BWH indicator before the April deadline, because the taxpayer was low income. There was unreported income in a prior year, but the taxpayer was compliant since that time. The taxpayer was on an installment agreement (IA) for \$25 per month, but she paid \$50 per month to expedite full payment, when she could not afford it.<sup>180</sup> TAS sent an OAR to stop the BWH. The IRS said the taxpayer was "only potentially liable" and it would not reverse the BWH indicator.

<sup>168</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>169</sup> Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

<sup>170</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>171</sup> See Most Serious Problem: *Form 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It To Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations*, *supra*; National Taxpayer Advocate FY 2017 Objectives Report to Congress 181-83 (Area of Focus: *The IRS Is Aware that a Significant Proportion of Form 1023-EZ Applications It Approves Are Submitted by Organizations that Do Not Meet the Legal Requirements for IRC § 501(c)(3) Status, But It Has Not Acted to Correct Known Errors and Has Not Revised the Form to Prevent These Erroneous Approvals*); National Taxpayer Advocate 2015 Annual Report to Congress 36-44 (Most Serious Problem: *Exempt Organizations: Form 1023-EZ: Recognition as a Tax-Exempt Organization Is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to be Taxable*); National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 3-32 (*Study of Taxpayers that Obtained Recognition as Section 501(c)(3) Organizations on the Basis of Form 1023-EZ*), noting that in a representative sample of organizations whose Form 1023-EZ application was approved, 37 percent did not meet the requirements for exempt status as a section 501(c)(3) organization as a matter of law.

<sup>172</sup> Data obtained from TAMIS (Oct. 1, 2016).

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> IRC § 3406. IRM 5.19.3.1, *Backup Withholding ("B" and "C" Programs) Program Overview* (Nov. 5, 2015) states: "The objective of the Backup Withholding (BWH) program is to ensure payers withhold tax from certain Form 1099 income when taxpayers have underreported their income, or incorrectly reported a Taxpayer Identification Number (TIN) to the payer. IRC § 3406 authorizes the withholding of tax for the BWH program."

<sup>180</sup> See Most Serious Problem: *Installment Agreements (IAs): The IRS Is Failing to Properly Evaluate Taxpayers' Living Expenses and Is Placing Taxpayers in IAs They Cannot Afford*, *supra*.



TAS responded with the guidance that stated what the IRS needed to do for “potential” situations. The collection manager said her decision was final and the OAR was closed “on their end” regardless of what TAS said, in violation of the SLA between TAS and the function. After TAS made multiple attempts to discuss the issue with multiple levels of IRS management without a response or with inappropriate responses, TAS issued a TAO to get the action completed. The IRS removed the BWH indicator. TAS had to follow-up due to an IRS error. Subsequently, the taxpayer completed her IA.<sup>181</sup>

A taxpayer came to TAS after the IRS offset the taxpayer’s refund to pay a prior year tax debt. TAS accepted the taxpayer’s oral testimony regarding financial hardship. The taxpayer was unemployed with medical issues and behind on bills. ACS would not accept TAS’s memorandum confirming the taxpayer’s financial hardship, saying the IRS allows only written proof from third parties. Per the Internal Revenue Manual, TAS may provide the memorandum, accepting oral testimony from the taxpayer or third parties.<sup>182</sup> After TAS issued a TAO, the IRS allowed the refund.<sup>183</sup>

#### TAXPAYER ASSISTANCE ORDERS (TAOs) TO APPEALS

TAS issued five TAOs during FY 2016 to the Office of Appeals, and Appeals complied with three.<sup>184</sup> TAS rescinded one at the taxpayer’s request; one TAO remains in process.<sup>185</sup>

In the TAO that remains in process, the LTA had issued a TAO to the Appeals Supervisory Appeals Officer, who appealed it. The TAS Deputy Executive Director Case Advocacy then sustained the TAO, and the Director of Appeals Campus Operations again appealed the TAO. The National Taxpayer Advocate then sustained the TAO to the Chief of Appeals. The Chief of Appeals appealed the TAO, providing a written response explaining why Appeals refused to comply with the TAO. After reviewing the memorandum that accompanied the appealed TAO, the National Taxpayer Advocate re-issued the TAO to the Chief of Appeals. The reissued TAO ordered the Chief of Appeals to reconsider her decision and detailed additional facts and law in response to concerns the Chief of Appeals had raised in her memorandum appealing the TAO. The Chief of Appeals refused to consider the National Taxpayer Advocate’s second TAO, contending that there is no IRM authority for reconsideration of a TAO. Although there are no IRM procedures addressing the issue, the Office of Chief Counsel advised the Chief of Appeals that there was no legal bar to the National Taxpayer Advocate asking for such reconsideration. The Chief of Appeals still declined to reconsider based on the new information and analysis provided. The National Taxpayer Advocate then requested a legal opinion from the Office of Chief Counsel as to whether the National Taxpayer Advocate has the authority under IRC § 7811 to issue a TAO to request that an officer or employee of the IRS reconsider his or her response to an earlier TAO, if the second request is accompanied by a new memorandum addressing the concerns raised by that official in the request for appeal. Counsel opined that the National Taxpayer Advocate does have that

181 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer’s case. Release signed by the taxpayer dated Aug. 8, 2016.

182 IRM 13.1.18.6.1, *Reviewing and Requesting Information from Taxpayers* (May 5, 2016); IRM 3.17.79.3.3(2) *Issuing Hardship Refunds* (Sept. 15, 2015); IRM 3.17.79.6.4(2) *Certifying Automated Clearing House (ACH) Direct Deposit Refunds* (Jan. 1, 2016; June 15, 2016).

183 In this instance, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to the taxpayer’s case. Release signed by the taxpayer dated Jul. 29, 2016.

184 Data obtained from TAMIS (Oct. 1, 2016).

185 *Id.*



authority.<sup>186</sup> Thus, the refusal to reconsider the National Taxpayer Advocate's request was not supported by the law.

### Congressional Case Trends

Taxpayers often turn to their congressional representatives when faced with IRS issues. The congressional representatives refer these taxpayers to TAS, which is responsible for responding to tax account inquiries sent to the IRS by members of Congress. Figure 4.1.18 reflects the total congressional case receipts and total TAS receipts from other contacts.

**FIGURE 4.1.18**<sup>187</sup>

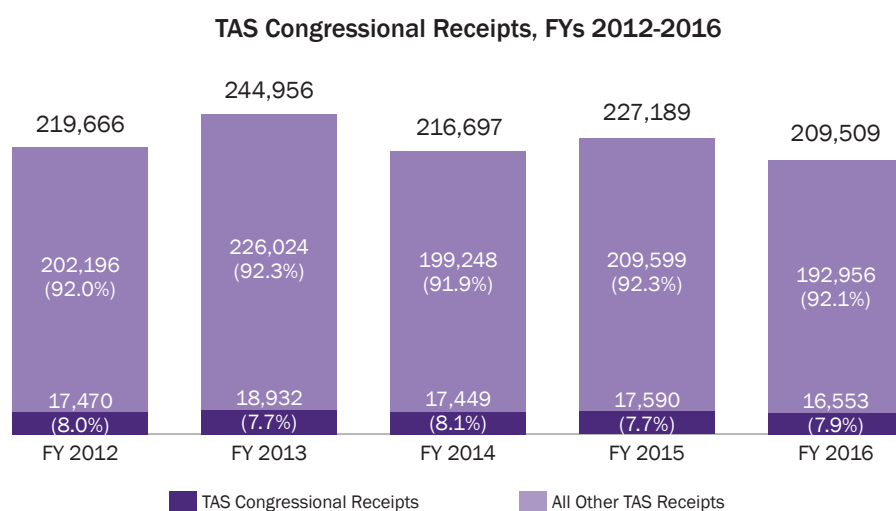


Figure 4.1.19 shows the top ten PCICs causing taxpayers to seek the assistance of their congressional representatives. Identity Theft receipts decreased by more than 24 percent between FY 2015 and FY 2016 and Pre-Refund Wage Verification Holds decreased by more than 32 percent.<sup>188</sup> These trends followed the overall TAS decrease in receipts for these issues. Congressional inquiries on behalf of constituents for Premium Tax Credit issues increased by about 104 percent, similarly to TAS receipts from other sources.<sup>189</sup> Applications for Exempt Status cases from congressional referrals declined by 33 percent, which was similar to the decline in TAS cases overall for this issue.<sup>190</sup>

<sup>186</sup> Memorandum from Janice Feldman, Special Counsel to the National Taxpayer Advocate, Office of Chief Counsel, to Nina Olson, National Taxpayer Advocate (Nov. 17, 2016).

<sup>187</sup> Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015; Oct. 1, 2016).

<sup>188</sup> Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

<sup>189</sup> *Id.*

<sup>190</sup> PCIC 460 Application for Exempt Status cases from all sources, including congressional referrals, were 931 in FY 2015 and 486 in FY 2016, which was a decline of about 48 percent.

**FIGURE 4.1.19, TAS Top Ten Congressional Receipts by Primary Core Issue Code, FYs 2015–2016<sup>191</sup>**

| Rank | Issue Description   | FY 2015       | FY 2016       | Percent %    |
|------|---|---------------|---------------|--------------|
| 1    | Identity Theft  | 3,378         | 2,556         | -24.3%       |
| 2    | Pre-Refund Wage Verification Hold                                   | 1,571         | 1,062         | -32.4%       |
| 3    | Processing Original Return  | 871           | 852           | -2.2%        |
| 4    | Processing Amended Return   | 838           | 731           | -12.8%       |
| 5    | Other Refund Inquiry/Issue  | 417           | 569           | 36.5%        |
| 6    | Health Insurance Premium Tax Credit for Individuals Under IRC § 36B | 278           | 568           | 104.3%       |
| 7    | Transcript Request  | 502           | 517           | 3.0%         |
| 8    | Installment Agreement   | 528           | 498           | -5.7%        |
| 9    | Unpostable and Rejects  | 308           | 492           | 59.7%        |
| 10   | Failure to File Penalty (FTF)/Failure to Pay Penalty (FTP)          | 564           | 465           | -17.6%       |
|      | Other Issues  | 8,335         | 8,243         | -1.1%        |
|      | <b>Total Congressional Receipts</b>                                 | <b>17,590</b> | <b>16,553</b> | <b>-5.9%</b> |

<sup>191</sup> Data obtained from TAMIS (Oct. 1, 2015; Oct. 1, 2016).

## Top 25 Case Advocacy Issues for FY 2016 by TAMIS\* Receipts

| Issue Code                   | Description   | FY 2016 Case Receipts |
|------------------------------|---|-----------------------|
| 425                          | Identity Theft  | 41,819                |
| 45                           | Pre-Refund Wage Verification Hold   | 29,174                |
| 63x – 640                    | Earned Income Tax Credit  | 11,378                |
| 920                          | Health Insurance Premium Tax Credit for Individuals under Internal Revenue Code (IRC) § 36B | 10,910                |
| 330                          | Processing Amended Return   | 9,671                 |
| 318                          | Taxpayer Protection Program Unpostables   | 7,160                 |
| 315                          | Unpostable and Reject   | 6,938                 |
| 310                          | Processing Original Return  | 6,325                 |
| 620                          | Reconsideration of Audits and Substitute for Return under IRC § 6020(b)                     | 6,264                 |
| 71x                          | Levies  | 5,626                 |
| 40                           | Returned/Stopped Refunds  | 4,946                 |
| 340                          | Injured Spouse Claim  | 4,752                 |
| 75x                          | Installment Agreements  | 3,943                 |
| 90                           | Other Refund Inquiries or Issues  | 3,855                 |
| 610                          | Open Audit - Non Earned Income Credit   | 3,852                 |
| 60                           | IRS Offset  | 3,160                 |
| 72x                          | Liens   | 3,072                 |
| 670                          | Closed Automated Underreporter  | 2,954                 |
| 520                          | Failure to File Penalty/Failure to Pay Penalty  | 2,330                 |
| 320                          | Math Error  | 2,139                 |
| 10                           | Lost or Stolen Refunds  | 2,089                 |
| 540                          | Civil Penalties other than Trust Fund Recovery Penalty                                      | 1,973                 |
| 210                          | Missing or Incorrect Payments   | 1,969                 |
| 790                          | Other Collection Issues   | 1,851                 |
| 91x                          | Appeals   | 1,800                 |
| <b>Total Top 25 Receipts</b> |   | <b>179,950</b>        |
| <b>Total TAS Receipts</b>    |   | <b>209,509</b>        |

\* Taxpayer Advocate Management Information System (TAMIS).

## Glossary of Acronyms

| Acronym | Definition  |
|---------|---|
| AA      | Acceptance Agent  |
| ABA     | American Bar Association                                  |
| ABDC    | Alaska Business Development Center                        |
| ACA     | Affordable Care Act                                       |
| ACS     | Automated Collection System                               |
| ACSI    | American Customer Satisfaction Index                      |
| ACSS    | Automated Collection System Support                       |
| ACTC    | Additional Child Tax Credit                               |
| ADR     | Alternative Dispute Resolution or Address Research System |
| AGI     | Adjusted Gross Income                                     |
| AIA     | Anti-Injunction Act                                       |
| AIMS    | Audit Information Management System                       |
| AJAC    | Appeals Judicial Approach and Culture                     |
| ALE     | Allowable Living Expenses or Applicable Large Employer    |
| ALERTS  | Automated Labor and Employee Relations Tracking System    |
| ALJ     | Administrative Law Judge                                  |
| AM      | Accounts Management                                       |
| AMBC    | American Battle Monuments Commission                      |
| AMS     | Accounts Management System                                |
| AMT     | Alternative Minimum Tax                                   |
| ANCOVA  | Analysis of Covariance                                    |
| AO      | Appeals Officer   |
| AOD     | Action on Decision  |
| AOIC    | Automated Offer In Compromise                             |
| AOTC    | American Opportunity Tax Credit                           |
| APA     | Administrative Procedure Act or Advance Pricing Agreement |
| APTC    | Advance Premium Tax Credit                                |
| ARC     | Annual Report to Congress                                 |
| ARDI    | Accounts Receivable Dollar Inventory                      |
| ASA     | Average Speed of Answer                                   |
| ASD     | Autistic Spectrum Disorder                                |
| ASFR    | Automated Substitute for Return                           |
| ATAO    | Application for Taxpayer Assistance Order                 |
| ATM     | Automated Teller Machine                                  |
| ATO     | Australian Taxation Office                                |
| AUR     | Automated Underreporter                                   |

| Acronym | Definition   |
|---------|--|
| AVS     | ACA Verification System                                    |
| BFS     | Bureau of Fiscal Services                                  |
| BIT     | Behavioural Insights Team                                  |
| BLS     | Bureau of Labor Statistics                                 |
| BMF     | Business Master File                                       |
| BOD     | Business Operating Division                                |
| BOLO    | Be On the Lookout  |
| BPMS    | Business Performance Management System                     |
| BPR     | Business Performance Review                                |
| BRRM    | Business Rules and Requirements Management                 |
| BTA     | Board of Tax Appeals                                       |
| BWH     | Back-Up Withholding  |
| CA      | Consular Affairs   |
| CAA     | Certifying Acceptance Agent                                |
| CAP     | Collection Appeals Program                                 |
| CAR     | Collection Activity Report                                 |
| CARE    | Customer Assistance, Relationships and Education           |
| CBO     | Congressional Budget Office                                |
| CCDM    | Chief Counsel Directives Manual                            |
| CCH     | Commerce Clearing House                                    |
| CCI     | Centralized Case Intake                                    |
| CCM     | Claimant Compliance Manual                                 |
| CDC     | Center for Disease Control and Prevention                  |
| CDCC    | Child and Dependent Care Credit                            |
| CDP     | Collection Due Process                                     |
| CDR     | Coverage Data Repository                                   |
| CDW     | Compliance Data Warehouse                                  |
| CEO     | Chief Executive Officer                                    |
| CES     | Consumer Expenditure Survey or Center for Economic Studies |
| CET     | Cognitive Evaluation Theory                                |
| CFO     | Chief Financial Officer                                    |
| CFPB    | Consumer Financial Protection Bureau                       |
| CHP     | COPS Hiring Program  |
| CHRG    | Congressional Hearing                                      |
| CI      | Criminal Investigation (Division)                          |
| CIAT    | Inter-American Center of Tax Administrations               |

| Acronym | Definition  |
|---------|---|
| CIP     | Compliance Initiative Projects  |
| CIS     | Correspondence Imaging System or Collection Information Statement                                     |
| CIO     | Chief Information Officer   |
| CLD     | Communication, Liaison, and Disclosure  |
| CMR     | Customer Managed Relationships  |
| CMS     | Centers for Medicare and Medicaid Services  |
| CNC     | Currently Not Collectible   |
| COED    | Commitments, Obligations, Expenditures, and Disbursements   |
| COIC    | Centralized Offer in Compromise   |
| CONOPS  | Concept of Operations   |
| COP-MED | Community Oriented Policing Management Education and Development Program                              |
| COPS    | Community Oriented Policing Services  |
| CPA     | Certified Public Accountant   |
| CRA     | Canada Revenue Agency   |
| CRM     | Customer Relationship Management  |
| CSCO    | Compliance Services Collection Operations   |
| CSED    | Collection Statute Expiration Date  |
| CSO     | Communication and Stakeholder Outreach  |
| CSR     | Customer Service Representative   |
| CTAS    | Comprehensive Taxpayer Attitude Survey  |
| CTC     | Child Tax Credit  |
| CVE     | Countering Violent Extremism  |
| CWC     | Client Contact – Work Management – Case Management System   |
| CX      | Customer Experience   |
| CY      | Calendar Year   |
| DCI     | Data Collection Instrument  |
| DCSE    | Deputy Commissioner for Services and Enforcement  |
| DDb     | Dependent Database  |
| DIAN    | Dirección de Impuestos y Aduanas Nacionales (de Colombia) - Directorate of National Taxes and Customs |
| DIF     | Discriminant Income Function  |
| DIT     | Defining Issues Test  |
| DMER    | Data Metrics & Error Resolution   |
| DMS     | Debt Management Service   |
| DOD     | Department of Defense   |
| DOJ     | Department of Justice   |

| Acronym | Definition   |
|---------|--|
| EAST    | Easy, Attractive, Social, and Timely                       |
| EB      | Economic Burden  |
| ECCR    | Environmental Collaboration and Conflict Resolution        |
| ECFM    | ECM Fraud Case Management                                  |
| ECM     | Enterprise Case Management                                 |
| ECN     | Exemption Certification Number                             |
| ECS     | Enterprise Case Selection                                  |
| EDCA    | Executive Director Case Advocacy                           |
| EFDS    | Electronic Fraud Detection System                          |
| EGTRRA  | Economic Growth and Tax Relief Reconciliation Act          |
| EIN     | Employer Identification Number                             |
| EITC    | Earned Income Tax Credit                                   |
| EMEA    | Europe, Middle East and Africa                             |
| EO      | Exempt Organization  |
| EPA     | Environmental Protection Agency                            |
| EPCU    | Employee Plans Compliance Unit                             |
| EPD     | Exchange Periodic Data                                     |
| EPIQ    | Excellence through Productivity Improvements and Quality   |
| ERIS    | Enforcement Revenue Information System                     |
| ERS     | Error Resolution System                                    |
| ESC     | Executive Steering Committee                               |
| ESL     | English as a Second Language                               |
| ESRP    | Employer Shared Responsibility Payment                     |
| ETAAC   | Electronic Tax Administration Advisory Committee           |
| ETARAS  | Electronic Tax Administration Research and Analysis System |
| ETLA    | Electronic Tax Law Assistance                              |
| FACA    | Federal Advisory Committee Act                             |
| EU      | European Union   |
| FAIR    | Federal Activities Inventory Reform                        |
| FAST    | Fixing America's Surface Transportation Act                |
| FATCA   | Foreign Account Tax Compliance Act                         |
| FBAR    | Foreign Bank and Financial Accounts                        |
| FCC     | Federal Communications Commission                          |
| FCW     | Federal Computer Week                                      |
| FDA     | Food and Drug Administration                               |
| FDIC    | Federal Deposit Insurance Corporation                      |

| Acronym | Definition   |
|---------|--|
| FFIEC   | Federal Financial Institutions Examination Council |
| FICA    | Federal Insurance Contributions Act                |
| FICO    | Fair Isaac Corporation                             |
| FIRPTA  | Foreign Investment in Real Property Tax Act        |
| FOIA    | Freedom of Information Act                         |
| FP      | Full Pay   |
| FPL     | Federal Poverty Level                              |
| FPLP    | Federal Payment Levy Program                       |
| FPR     | False Positive Rate                                |
| FS      | Filing Season                                      |
| FSCU    | Food, Shelter, Clothing, and Utilities             |
| FSP     | Family Security Program                            |
| FTA     | Federation of Tax Administrators                   |
| FTB     | Franchise Tax Board or Family Tax Benefit          |
| FTD     | Federal Tax Deposit                                |
| FTE     | Full-Time Employee                                 |
| FTF     | Failure To File                                    |
| FTL     | Federal Tax Lien                                   |
| FTM     | Fast Track Mediation                               |
| FTP     | Failure To Pay                                     |
| FTS     | Fast Track Settlement                              |
| FUTA    | Federal Unemployment Tax Act                       |
| FY      | Fiscal Year  |
| GAO     | Government Accountability Office                   |
| GDP     | Gross Domestic Product                             |
| GFP     | Great (or Global) Futures Program                  |
| GSA     | General Services Administration                    |
| HCO     | Human Capital Office                               |
| HERCA   | Health Care & Education Reconciliation Act of 2010 |
| HHI     | Household Income                                   |
| HMRC    | Her Majesty's Revenue and Customs                  |
| HOH     | Head of Household                                  |
| IA      | Installment Agreement                              |
| IDES    | International Data Exchange Service                |
| IDT     | Identity Theft                                     |
| IDTVA   | Identity Theft Victim Assistance                   |
| IGM     | Interim Guidance Memorandum                        |
| IGT     | Inspector General of Taxation                      |

| Acronym | Definition  |
|---------|---|
| ILTAM   | Institutionalist Legislative Theory and Methodology         |
| IMF     | Individual Master File                                      |
| IMFOLE  | Individual Master File On-Line Entity                       |
| IP PIN  | Identity Protection Personal Identification Number          |
| IR      | Inland Revenue  |
| IRA     | Individual Retirement Account                               |
| IRB     | Internal Revenue Bulletin                                   |
| IRC     | Internal Revenue Code                                       |
| IRDM    | Information Reporting Document Matching                     |
| IRDMCM  | Information Reporting and Document Matching Case Management |
| IRM     | Internal Revenue Manual                                     |
| IRMF    | Information Returns Master File                             |
| IRP     | Information Reporter Program                                |
| IRS     | Internal Revenue Service                                    |
| IRSAC   | Internal Revenue Service Advisory Council                   |
| IRTF    | Individual Returns Transaction File                         |
| IS&R    | Information Sharing and Reporting                           |
| ISRP    | Individual Shared Responsibility Payment                    |
| IT      | Information Technology                                      |
| ITIN    | Individual Taxpayer Identification Number                   |
| ITRIP   | Income Tax Refund Integrity Program                         |
| ITS     | Intake and Technical Support                                |
| IVO     | Integrity & Verification Operation                          |
| IVR     | Interactive Voice Response                                  |
| IWV     | Income Wage Verification                                    |
| JCT     | Joint Committee on Taxation                                 |
| JOC     | Joint Operations Center                                     |
| JSRP    | Joint Statistical Research Program                          |
| KPI     | Key Performance Indicators                                  |
| LBE     | Lower-Bound Estimate  |
| LB&I    | Large Business and International Operating Division         |
| LEMAS   | Law Enforcement Management and Administrative Statistics    |
| LEP     | Limited English Proficiency                                 |
| LIF     | Low Income Filter   |
| LITC    | Low Income Taxpayer Clinic                                  |
| LLC     | Limited Liability Company                                   |



| Acronym   | Definition  |
|-----------|---|
| LLP       | Limited Liability Partnership   |
| LMSB      | Large and Mid-Sized Business  |
| LOS       | Level of Service  |
| LR        | Legislative Recommendation  |
| MEC       | Minimal Essential Coverage  |
| MFJ       | Married Filing Joint  |
| MFS       | Married Filing Separately   |
| MINDSPACE | Messenger, Incentives, Norms, Defaults, Salience, Priming, Affect, Commitments, Ego |
| MIT       | Massachusetts Institute of Technology   |
| MLI       | Most Litigated Issue  |
| MLRO      | Money Laundering Reporting Officer  |
| MOU       | Memorandum of Understanding   |
| MSA       | Metropolitan Statistical Area   |
| MSP       | Most Serious Problem  |
| MTU       | Mobile Tax Unit   |
| NACUBO    | National Association of College and University Business Officers                    |
| NAS       | National Academy of Sciences  |
| NASCO     | National Association of State Charities Officials                                   |
| NBER      | National Bureau of Economic Research  |
| NCHS      | National Center for Health Statistics   |
| NCR       | Net Compliance Rate   |
| NEC       | Non-Employee Compensation   |
| NEH       | National Endowments for the Arts and Humanities                                     |
| NFIB      | National Federation of Independent Businesses                                       |
| NFTL      | Notice of Federal Tax Lien  |
| NIH       | National Institutes of Health   |
| NIST      | National Institute of Standards and Technology                                      |
| NLM       | National Library of Medicine  |
| NMP       | Net Misreporting Percentage   |
| NOAA      | National Oceanic and Atmospheric Administration                                     |
| NRC       | National Research Council   |
| NRP       | National Research Program   |
| NSD       | National Sales Director   |
| NSF       | National Science Foundation   |
| NTA       | National Taxpayer Advocate  |

| Acronym | Definition   |
|---------|--|
| NTEU    | National Treasury Employees Union                              |
| NYPD    | New York Police Department                                     |
| OAR     | Operations Assistance Request                                  |
| OASDI   | Old Age, Survivors, and Disability Insurance (Social Security) |
| OD      | Operating Division   |
| ODAR    | Office of Disability Adjudication and Review                   |
| OECD    | Organisation for Economic Co-Operation and Development         |
| OFAC    | Office of Foreign Assets Control                               |
| OIC     | Offer in Compromise  |
| OJI     | On-the-Job Instruction   |
| OMB     | Office of Management and Budget                                |
| OPS     | Operations Planning & Support                                  |
| OS      | Operations Support   |
| OSR     | Office of State Revenue  |
| OSTP    | Office of Science and Technology Policy                        |
| OTA     | Office of Tax Analysis   |
| OTC     | Office of Taxpayer Correspondence                              |
| OUO     | Official Use Only  |
| OVDI    | Offshore Voluntary Disclosure Initiative                       |
| OVDP    | Offshore Voluntary Disclosure Program                          |
| PAM     | Post Appeals Mediation   |
| PATH    | Protecting Americans from Tax Hikes                            |
| PAYE    | Pay-As-You-Earn  |
| PCA     | Private Collection Agency                                      |
| PCI     | Potentially Collectible Inventory                              |
| PCIC    | Primary Core Issue Code  |
| PDC     | Post-Determination Process or Private Debt Collection          |
| PEO     | Professional Employer Organization                             |
| PEP     | Politically Exposed Persons                                    |
| PIN     | Personal Identification Number                                 |
| PIT     | Personal Income Tax  |
| PIV     | Personal Identity Verification                                 |
| POA     | Power Of Attorney  |
| POP     | Problem-Oriented Policing                                      |
| PPG     | Policy and Procedure Guide                                     |
| PPIA    | Partial Pay Installment Agreement                              |
| PRA     | Paperwork Reduction Act  |
| PRWVH   | Pre-Refund Wage Verification hold                              |

| Acronym    | Definition  |
|------------|---|
| PSCI       | Public Service Charter Implementation   |
| PSP        | Payroll Service Provider  |
| PTC        | Premium Tax Credit  |
| PTSD       | Post-Traumatic Stress Disorder  |
| PwC        | PricewaterhouseCoopers  |
| QC         | Qualifying Child  |
| RAAS       | Research, Analysis, and Statistics or Research, Applied Analytics, and Statistics |
| RAND       | Research and Development  |
| RAS        | (Office of) Research, Analysis and Statistics                                     |
| RCT        | Randomized Controlled Trials  |
| RCA        | Reasonable Cause Assistant  |
| RDC        | Research Data Centers or Research Development Center                              |
| RDD        | Random-Digit Dialing or Dialed  |
| RESPA      | Real Estate Settlement Procedures Act   |
| RIA        | Research Institute of America   |
| RICS       | Return Integrity and Correspondence Services                                      |
| RO         | Revenue Officer   |
| ROI        | Return on Investment  |
| ROS        | Revenue On-line Service   |
| RPM        | Return Preparer Misconduct  |
| RRA 98     | Internal Revenue Service Restructuring and Reform Act of 1998                     |
| RRB        | Railroad Retirement Board   |
| RRP        | Return Review Program   |
| RRTA       | Railroad Retirement Tax Act   |
| SAMS       | Systemic Advocacy Management System   |
| SARS       | South African Revenue Service   |
| SB/SE      | Small Business/Self-Employed Operating Division                                   |
| SB/SE FR&S | Small Business/Self Employed Finance, Research and Strategy                       |
| SBA        | Small Business Administration   |
| SBST       | Social and Behavioral Sciences Team   |
| SCIC       | Secondary Core Issue Code   |
| SCS        | Servicewide Compliance Strategy   |
| SERP       | Servicewide Electronic Research Program   |
| SFR        | Substitute for Return   |
| SIFMA      | Securities Industry and Financial Markets Association                             |
| SIPP       | Survey of Income and Program Participation  |

| Acronym | Definition  |
|---------|---|
| SLA     | Service Level Agreement                             |
| SLF     | Stakeholder Liaison Field                           |
| SME     | Small/Medium Enterprise                             |
| SNAP    | Supplemental Nutrition Assistance Program           |
| SNOD    | Statutory Notice of Deficiency                      |
| SO      | Settlement Officer                                  |
| SOI     | Statistics of Income                                |
| SPEC    | Stakeholder Partnerships, Education & Communication |
| SPM     | Supplemental Poverty Measure                        |
| SPP     | Service Priorities Project                          |
| SSA     | Social Security Administration                      |
| SSDI    | Social Security Disability Insurance or Income      |
| SSI     | Supplemental Security Income                        |
| SSN     | Social Security Number                              |
| SST     | Self-Service Technologies                           |
| TAB     | Taxpayer Assistance Blueprint                       |
| TAC     | Taxpayer Assistance Center                          |
| TAD     | Taxpayer Advocate Directive                         |
| TAMIS   | Taxpayer Advocate Management Information System     |
| TANF    | Temporary Assistance to Needy Families              |
| TAO     | Taxpayer Assistance Order                           |
| TAS     | Taxpayer Advocate Service                           |
| TASIS   | Taxpayer Advocate Service Integrated System         |
| TBOR    | Taxpayer Bill of Rights                             |
| TCAL    | Tax Collection and Administration Law               |
| TCM     | Taxpayer Choice Model                               |
| TDA     | Taxpayer Delinquent Account                         |
| TDC     | Taxpayer Digital Communication                      |
| TDI     | Taxpayer Delinquent Investigation                   |
| TE/GE   | Tax Exempt & Government Entities Operating Division |
| TFB     | Tools for Businesses                                |
| TFRP    | Trust Fund Recovery Penalty                         |
| TIA     | Tax Injunction Act                                  |
| TIGTA   | Treasury Inspector General for Tax Administration   |
| TIN     | Taxpayer Identification Number                      |
| TPC     | Tax Policy Center                                   |
| TPI     | Total Positive Income                               |

| Acronym | Definition  |
|---------|---|
| TPNC    | Taxpayer Notice Codes   |
| TRHCA   | Tax Relief and Health Care Act  |
| TRRB    | Tax Research Review Board   |
| TSA     | Transportation Security Administration                                    |
| TSC     | Terrorist Screening Center  |
| TSDB    | Terrorist Screening Data Base   |
| TY      | Tax Year  |
| UDOC    | Uniform Definition of a Child   |
| UMDA    | Uniform Marriage and Divorce Act  |
| UNAX    | Unauthorized Access of Taxpayer Account                                   |
| UK      | United Kingdom  |
| USAID   | United States Agency for International Development                        |
| USCIS   | U.S. Citizenship and Immigration Service                                  |
| USDL    | U.S. Department of Labor  |
| UWR     | Unified Work Request  |
| VA      | Veterans Affairs  |
| VAT     | Value Added Tax   |
| VCR     | Voluntary Compliance Rate   |
| VITA    | Volunteer Income Tax Assistance   |
| W&I     | Wage and Investment Operating Division                                    |
| WIPRO   | Western India Palm Refined Oils Limited or Western India Products Limited |
| YTD     | Year to Date  |

**TABLE 1 Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)**

| Case Citation   | Issue(s)   | Pro Se | Decision |
|---|--|--------|----------|
| <b>Individual Taxpayers (But Not Sole Proprietorships)</b>  |  |        |          |
| <i>Adams v. Comm’r</i> , T.C. Memo. 2015-162, appeal dismissed, No. 16-1043 (4th Cir. May 20, 2016)                           | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Ashmore v. Comm’r</i> , T.C. Memo. 2016-36   | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Avery v. Comm’r</i> , T.C. Memo. 2016-50   | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith reliance on tax professional                                     | Yes    | IRS      |
| <i>Barnes v. Comm’r</i> , T.C. Memo. 2016-79  | 6662(b)(1) - TPs (H&W) negligent in claiming clothing deductions; however, they acted with reasonable cause and in good faith with respect to their charitable contribution deductions | Yes    | Split    |
| <i>Beaubrun v. Comm’r</i> , T.C. Memo. 2015-217   | 6662(b)(1) - TP negligent in failing to substantiate items properly and report self-employment income; failure to argue reasonable cause and good faith                                | No     | IRS      |
| <i>Beltifa v. Comm’r</i> , T.C. Summ. Op. 2016-8  | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Blackbourn v. Comm’r</i> , T.C. Summ. Op. 2016-5   | 6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith   | Yes    | TP       |
| <i>Blanco v. U.S.</i> , 117 A.F.T.R.2d (RIA) 529 (D. Colo. 2016)  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith   | No     | IRS      |
| <i>Boneparte v. Comm’r</i> , T.C. Memo. 2015-128  | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Briggs v. Comm’r</i> , T.C. Memo. 2016-86  | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Brinkley v. Comm’r</i> , 808 F.3d 657 (5th Cir. 2015), <i>aff’g</i> T.C. Memo. 2014-227                                    | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional  | No     | IRS      |
| <i>Carroll v. Comm’r</i> , 146 T.C. No. 13 (2016)   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Chaudry v. Comm’r</i> , T.C. Summ. Op. 2015-74   | 6662(b)(1), (2) - TPs negligent in failing to maintain records; TP substantially understated income tax; failure to argue reasonable cause and good faith                              | Yes    | IRS      |
| <i>Co v. Comm’r</i> , T.C. Memo. 2016-19  | 6662(b)(2) - TP acted with reasonable cause and in good faith  | No     | TP       |
| <i>Crabtree v. Comm’r</i> , T.C. Memo. 2015-163   | 6662(b)(1), (2) - Amounts received by TP were not taxable alimony payments and TP therefore not liable for accuracy-related penalty  | No     | TP       |
| <i>Dieringer, Estate of, v. Comm’r</i> , 146 T.C. No. 8 (2016), <i>appeal docketed</i> , No. 16-72640 (9th Cir. Aug. 8, 2016) | 6662(b)(1) - TP negligent in estate appraisal; failure to establish reasonable cause and good faith reliance on tax professional   | No     | IRS      |
| <i>Dulanto v. Comm’r</i> , T.C. Memo. 2016-34, <i>appeal docketed</i> , No. 16-72867 (9th Cir. Aug. 29, 2016)                 | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Dunn v. Comm’r</i> , T.C. Memo. 2015-208   | 6662(b)(1) - TPs (H&W) negligent in claiming an improper IRA contribution deduction; failure to establish reasonable cause and good faith  | No     | IRS      |

TABLE 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

| Case Citation   | Issue(s)  | Pro Se | Decision |
|---|---|--------|----------|
| <i>Ezzell v. Comm’r</i> , T.C. Summ. Op. 2015-52  | 6662(b)(1) - IRS did not meet its burden as TP was not negligent and kept adequate books and records as well as substantiated the expenses underlying his deductions  | Yes    | TP       |
| <i>Fish v. Comm’r</i> , T.C. Memo. 2015-176, appeal docketed, No. 15-73389 (9th Cir. Nov. 5, 2015)          | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Friedman v. Comm’r</i> , T.C. Memo. 2015-177   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish substantial authority for excluding interest income   | No     | IRS      |
| <i>Garada v. Comm’r</i> , T.C. Summ. Op. 2016-1   | 6662(b)(1), (2) - TP (H&W) not negligent in failing to maintain books and records or substantiate items in question as IRS did not meet its burden of production; penalty for substantial understatement of income tax applies provisionally  | Yes    | Split    |
| <i>Garcia v. Comm’r</i> , T.C. Memo. 2016-21  | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Gassoway v. Comm’r</i> , T.C. Memo. 2015-203   | 6662(b)(2) - TP did not substantially understate income tax   | Yes    | TP       |
| <i>Gemperle v. Comm’r</i> , T.C. Memo. 2016-1   | 6662(b)(1) - TPs (H&W) negligent in failing to include a qualified appraisal with their return when claiming a charitable contribution deduction for donation of a conservation easement; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Ghafouri v. Comm’r</i> , T.C. Memo. 2016-6   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Gilbert v. Comm’r</i> , T.C. Summ. Op. 2016-17   | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Henao v. Comm’r</i> , T.C. Summ. Op. 2016-7  | 6662(b)(1) - TP negligent in failing to report taxable Social Security benefits and claiming certain improper employee business expense and charitable contribution deductions; TP established reasonable cause and good faith with respect to other employee business expense deductions but not for disallowed charitable contribution deductions | No     | Split    |
| <i>Huber v. Comm’r</i> , T.C. Summ. Op. 2015-63   | 6662(b)(1) - TP negligent in failing to maintain records and substantiate items; penalty applies provisionally; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Jones v. Comm’r</i> , 146 T.C. 39 (2016)   | 6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith reliance on tax professional   | No     | TP       |
| <i>Kott v. Comm’r</i> , T.C. Summ. Op. 2015-42  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Leland v. Comm’r</i> , T.C. Memo. 2015-240   | 6662(b)(1), (2) - TPs (H&W) properly deducted losses relating to farming activity and therefore not liable for accuracy-related penalty   | Yes    | TP       |
| <i>Mehriary v. Comm’r</i> , T.C. Memo. 2015-126   | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Minnick v. Comm’r</i> , 611 F. App’x 477 (9th Cir. 2015), <i>aff’g</i> T.C. Memo. 2012-345               | 6662(b)(1) - TP negligent in failing to comply with conservation easement deduction requirements; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Morales v. Comm’r</i> , 116 A.F.T.R.2d (RIA) 7021 (9th Cir. 2015), <i>aff’g</i> T.C. Memo. 2012-341      | 6662(b)(1) - TPs (H&W) negligent in claiming an improper first-time homebuyer credit; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Muniz v. Comm’r</i> , T.C. Memo. 2015-125, <i>aff’d</i> by docket No. 15-14478 (11th Cir. Oct. 13, 2016) | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |

TABLE 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

| Case Citation   | Issue(s)  | Pro Se | Decision |
|---|---|--------|----------|
| <i>Navaid v. Comm'r</i> , T.C. Memo. 2016-37  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Nuzum v. Comm'r</i> , T.C. Summ. Op. 2016-9  | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith   | No     | IRS      |
| <i>O'Connor v. Comm'r</i> , T.C. Memo. 2015-155, <i>aff'd</i> by docket No. 15-9006 (10th Cir. June 28, 2016) | 6662(b)(1) - TPs (H&W) negligently claimed deductions for H's legal education; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>O'Connor v. Comm'r</i> , T.C. Memo. 2015-244   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional  | No     | IRS      |
| <i>Read v. Comm'r</i> , T.C. Memo. 2015-115   | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Simmons-Brown v. Comm'r</i> , T.C. Summ. Op. 2015-62   | 6662(b)(1) - TPs (H&W) negligent in failing to report unemployment compensation for 2010; TPs not liable for penalty for 2011 as their rental activity was not a passive activity and therefore there was no underpayment and penalty | Yes    | Split    |
| <i>Starke v. Comm'r</i> , T.C. Summ. Op. 2015-40  | 6662(b)(1) - TP not liable for underlying tax and therefore not the penalty   | Yes    | TP       |
| <i>Taylor v. Comm'r</i> , T.C. Summ. Op. 2015-51  | 6662(b)(2) - TP acted with reasonable cause and in good faith in excluding his military retirement pay from gross income  | Yes    | TP       |
| <i>Tobias v. Comm'r</i> , T.C. Memo. 2015-164   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Tseytin v. Comm'r</i> , T.C. Memo. 2015-247, <i>appeal docketed</i> , No. 16-1674 (3d Cir. Mar. 25, 2016)  | 6662(b)(1) - TP negligent in treatment of separate blocks of stock as a single block; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Vandenbosch v. Comm'r</i> , T.C. Memo. 2016-29   | 6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith reliance on tax professional   | No     | TP       |
| <i>Webber v. Comm'r</i> , 144 T.C. 324 (2015)   | 6662(b)(2) - TP acted with reasonable cause and in good faith   | No     | TP       |
| <i>Wesley v. Comm'r</i> , T.C. Memo. 2015-200   | 6662(b)(1) - TPs (H&W) negligent in failing to report income; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Wilson v. Comm'r</i> , T.C. Summ. Op. 2016-19  | 6662(b)(1), (2) - TPs (H&W) acted with reasonable cause and good faith reliance on tax professional   | Yes    | TP       |
| <i>Yguico v. Comm'r</i> , T.C. Memo. 2015-230   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional  | Yes    | IRS      |
| <b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships- Schedules C, E, F)</b>   |   |        |          |
| <i>AD Inv. 2000 Fund LLC v. Comm'r</i> , T.C. Memo. 2015-223  | 6662(b)(1), (2) - TPs (business partners) negligent in failing to maintain records; TPs substantially understated income tax; failure to argue reasonable cause and good faith reliance on tax professional                           | No     | IRS      |
| <i>Amegankpoe v. Comm'r</i> , T.C. Summ. Op. 2015-36  | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Arizaga v. Comm'r</i> , T.C. Memo. 2016-57   | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Atkinson v. Comm'r</i> , T.C. Memo. 2015-236   | 6662(b)(1), (2) - TP acted with reasonable cause and in good faith  | No     | TP       |
| <i>Beck v. Comm'r</i> , T.C. Memo. 2015-149   | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith  | Yes    | IRS      |



TABLE 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

| Case Citation  | Issue(s)   | Pro Se | Decision |
|--|--|--------|----------|
| <i>Besaw v. Comm'r</i> , T.C. Memo. 2015-233, appeal docketed, No. 16-70264 (9th Cir. Jan. 28, 2016)   | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Boring v. Comm'r</i> , T.C. Summ. Op. 2015-68   | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Brinks Gilson &amp; Lione, P.C. v. Comm'r</i> , T.C. Memo. 2016-20  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional or substantial authority   | No     | IRS      |
| <i>Callender v. Comm'r</i> , T.C. Memo. 2016-68  | 6662(b)(1), (2) - TP negligent in failing to maintain records; TP substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Calvanico v. Comm'r</i> , T.C. Summ. Op. 2015-64  | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to argue reasonable cause and good faith  | Yes    | IRS      |
| <i>Cartwright v. Comm'r</i> , T.C. Memo. 2015-212  | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional   | No     | IRS      |
| <i>Chemtech Royalty Assocs., L.P. v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1750 (5th Cir. 2016), <i>aff'g</i> 115 A.F.T.R.2d (RIA) 1807 (M.D. La. 2015), petition for cert. filed, No. 16-347 (Sept. 14, 2016) | 6662(b)(1), (2) - TP negligent in sham partnership transactions; TP substantially understated income tax; failure to establish reasonable basis and substantial authority  | No     | IRS      |
| <i>Delia v. Comm'r</i> , T.C. Memo. 2016-71  | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith; however, TP permitted to deduct substantiated expenses and therefore penalty does not apply to these amounts   | Yes    | Split    |
| <i>DJB Holding Corp. v. Comm'r</i> , 803 F.3d 1014 (9th Cir. 2015)   | 6662(b)(2) - TP substantially understated income tax; failure to establish substantial authority, reasonable cause and good faith reliance on tax professional, or that law governing its position was not settled   | No     | IRS      |
| <i>Ellis v. Comm'r</i> , 787 F.3d 1213 (8th Cir. 2015), <i>aff'g</i> T.C. Memo. 2013-245   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Escalante v. Comm'r</i> , T.C. Summ. Op. 2015-47  | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Espallat v. Comm'r</i> , T. C. Memo. 2015-202   | 6662(b)(1), (2) - TPs (H&W) established reasonable cause and good faith reliance on tax professional   | No     | TP       |
| <i>Farris v. Comm'r</i> , T.C. Summ. Op. 2015-53   | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith reliance on tax professional   | No     | IRS      |
| <i>Fisher v. Comm'r</i> , T.C. Summ. Op. 2016-10   | 6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records for deductions of wages paid to TPs' children; TPs substantially understated income tax; TPs acted with reasonable cause and good faith reliance on tax professional regarding deductions taken for book writing activity but not for those taken for wages paid to TPs' children | Yes    | Split    |
| <i>Flying Hawk v. Comm'r</i> , T.C. Memo. 2015-139   | 6662(b)(1) - TP negligently claimed improper deductions and failed to establish reasonable cause and good faith; TP established reasonable cause with regard to an erroneous deduction   | Yes    | Split    |
| <i>Guarino v. Comm'r</i> , T.C. Summ. Op. 2016-12  | 6662(b)(2) - TPs (H&W) substantially understated income tax; TPs acted with reasonable cause and good faith regarding rental loss deductions but not for underpayments of tax attributable to their concessions  | Yes    | Split    |

TABLE 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

| Case Citation  | Issue(s)   | Pro Se | Decision |
|--|--|--------|----------|
| <i>Hoffmann v. Comm'r</i> , T.C. Memo. 2016-69   | 6662(b)(1), (2) - TPs (H&W) negligent in claiming improper deductions; TPs substantially understated income tax; failure to argue reasonable cause and good faith reliance on tax professional or substantial authority                              | No     | IRS      |
| <i>Hoffmann v. Comm'r</i> , T.C. Summ. Op. 2015-73   | 6662(b)(1), (2) - TPs negligent in failing to maintain records; failure to argue reasonable cause and good faith   | Yes    | IRS      |
| <i>Holden v. Comm'r</i> , T.C. Memo. 2015-131  | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith  | No     | IRS      |
| <i>Isaacs v. Comm'r</i> , T.C. Memo. 2015-121  | 6662(b)(1) - TP negligent in failing to maintain records and substantiate items properly; TP failed to establish reasonable cause and good faith for certain portions of underpayments but did for others  | Yes    | Split    |
| <i>Jasperson v. Comm'r</i> , T.C. Memo. 2015-186, <i>aff'd</i> , 118 A.F.T.R.2d (RIA) 5633 (11th Cir. Aug. 31, 2016)       | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional  | No     | IRS      |
| <i>Jijun Chen v. Comm'r</i> , T.C. Memo. 2015-167  | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Judah v. Comm'r</i> , T.C. Memo. 2015-243   | 6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith reliance on tax professional  | No     | TP       |
| <i>Kaiser v. Comm'r</i> , T.C. Summ. Op. 2016-13   | 6662(b)(1), (2) - TPs (H&W) negligent in failing to report income from state tax refund and provide evidence that horse training activity was for profit; TPs substantially understated income tax; failure to argue reasonable cause and good faith | Yes    | IRS      |
| <i>Kantchev v. Comm'r</i> , T.C. Memo. 2015-234  | 6662(b)(1) - TP negligent in failing to maintain records regarding business deductions; TP acted with reasonable cause and in good faith for loss carryover and flow through loss  | Yes    | Split    |
| <i>Kavuma v. Comm'r</i> , T.C. Memo. 2016-101  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Key Carpets, Inc. v. Comm'r</i> , T.C. Memo. 2016-30  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional  | No     | IRS      |
| <i>Kline v. Comm'r</i> , T.C. Memo. 2015-144   | 6662(b)(1) - TPs (H&W) acted with reasonable cause and in good faith   | No     | TP       |
| <i>Lamas-Richie v. Comm'r</i> , T.C. Memo. 2016-63   | 6662(b)(2) - TPs (H&W) acted with reasonable cause and in good faith reliance on tax professional  | Yes    | TP       |
| <i>Laudon v. Comm'r</i> , T.C. Summ. Op. 2015-54   | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional  | Yes    | IRS      |
| <i>Lawson v. Comm'r</i> , T.C. Memo. 2015-211  | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records and not including settlement proceeds in income; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Machacek v. Comm'r</i> , T.C. Memo. 2016-55   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional   | No     | IRS      |
| <i>Makric Enters., Inc. v. Comm'r</i> , T.C. Memo. 2016-44, <i>appeal docketed</i> , No. 16-60410 (5th Cir. June 17, 2016) | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional  | No     | IRS      |
| <i>McMillan v. Comm'r</i> , T.C. Memo. 2015-109  | 6662(b)(1), (2) - IRS failed to carry its burden of proving the grounds for the penalty and the absence of reasonable cause and good faith   | Yes    | TP       |

TABLE 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

| Case Citation   | Issue(s)   | Pro Se | Decision |
|---|--|--------|----------|
| <i>Moon v. Comm'r</i> , T.C. Summ. Op. 2016-23  | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith reliance on tax professional; however, TP entitled to take loss deductions from real estate activities and therefore penalty does not apply to these amounts  | No     | Split    |
| <i>Newhouse v. Comm'r</i> , T.C. Summ. Op. 2015-71  | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to argue reasonable cause and good faith  | Yes    | IRS      |
| <i>Niemann v. Comm'r</i> , T.C. Memo. 2016-11   | 6662(b)(2) - TP substantially understated income tax; TP acted with reasonable cause and in good faith reliance on tax professional for the 2010 tax year but not for 2009 tax year  | Yes    | Split    |
| <i>Nkonoki v. Comm'r</i> , T.C. Memo. 2016-93   | 6662(b)(1), (2) - Penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Ocampo v. Comm'r</i> , T.C. Memo. 2015-150   | 6662(b)(1) - TPs (H&W) negligent in failing to maintain records; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Ogden v. Comm'r</i> , T.C. Memo. 2015-241  | 6662(b)(1), (2) - TPs (H&W) negligent in failing to report income; TPs substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional   | Yes    | IRS      |
| <i>Okonkwo v. Comm'r</i> , T.C. Memo. 2015-181, appeal docketed, No. 16-71020 (9th Cir. Apr. 12, 2016)                      | 6662(b)(1), (2) - TPs (H&W) negligent in failing to maintain records; TPs substantially understated income tax; TPs established reasonable cause and good faith reliance on tax professional for improperly claimed rental home deductions but not for other deductions  | Yes    | Split    |
| <i>Omar v. Comm'r</i> , T.C. Memo. 2015-238   | 6662(b)(1) - TP negligent in failing to report income and maintain records; failure to establish reasonable cause and good faith   | No     | IRS      |
| <i>Our Country Home Enters., Inc. v. Comm'r</i> , 145 T.C. 1 (2015)   | 6662(b)(1), (2) - TP negligent in failing to maintain records; TP substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Philbrick v. Comm'r</i> , T.C. Memo. 2016-64   | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Pingel v. Comm'r</i> , T.C. Summ. Op. 2015-48  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith   | Yes    | IRS      |
| <i>Quintanilla v. Comm'r</i> , T.C. Memo. 2016-5  | 6662(b)(1) - TP not negligent as he properly deducted items on his schedule C; TP negligent in failing to report a state income tax refund   | Yes    | Split    |
| <i>Renner v. Comm'r</i> , T.C. Memo. 2015-102   | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Rochlani v. Comm'r</i> , T.C. Memo. 2015-174   | 6662(b)(2) - TPs (H&W) liable for penalty if there is an underpayment of tax after Rule 155 computational adjustments; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Schank v. Comm'r</i> , T.C. Memo. 2015-235   | 6662(b)(1), (2) - TPs (H&W) negligent in failing to make a reasonable attempt to comply with the provisions of the Code or to exercise ordinary and reasonable care in the preparation of their tax returns; TPs substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional | No     | IRS      |
| <i>Seismic Support Servs., LLC v. Comm'r</i> , T.C. Memo. 2015-151, appeal dismissed, No. 16-70216 (9th Cir. July 20, 2016) | 6662(b)(1) - TP (tax matters partner) negligent in mischaracterizing payments received from LLC  | Yes    | IRS      |

TABLE 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

| Case Citation  | Issue(s)  | Pro Se | Decision |
|--|---|--------|----------|
| <i>Senyszyn v. Comm'r</i> , 146 T.C. No. 9 (2016)  | 6662(b)(1), (2) - TPs (H&W) not liable for any deficiency and therefore penalties do not apply  | Yes    | TP       |
| <i>Smith v. Comm'r</i> , T.C. Memo. 2015-214   | 6662(b)(1), (2) - TP negligent in failing to maintain records; TP substantially understated income tax; failure to argue reasonable cause and good faith  | Yes    | IRS      |
| <i>Spjute v. Comm'r</i> , T.C. Summ. Op. 2015-58   | 6662(b)(1) - TP negligent in failing to maintain records; failure to establish reasonable cause and good faith reliance on tax professional   | No     | IRS      |
| <i>Steinberg v. Comm'r</i> , T.C. Memo. 2015-222   | 6662(b)(1) - TPs negligent in claiming loss deductions; failure to establish reasonable cause and good faith reliance on tax professional   | No     | IRS      |
| <i>Steinberger v. Comm'r</i> , T.C. Memo. 2016-104   | 6662(b)(2) - TP substantially understated income tax; TP acted with reasonable cause and good faith reliance on tax professional for two tax years but not for a third (penalty deemed conceded for third year) | No     | Split    |
| <i>Stough v. Comm'r</i> , 144 T.C. 306 (2015)  | 6662(b)(2) - TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith   | No     | IRS      |
| <i>Strode v. Comm'r</i> , 621 F. App'x 416 (9th Cir. 2015), <i>aff'g</i> T.C. Memo. 2012-59  | 6662(b)(2) - TP substantially understated income tax; failure to argue reasonable cause and good faith reliance on tax professional   | No     | IRS      |
| <i>Strode v. Comm'r</i> , T.C. Memo. 2015-117, <i>appeal docketed</i> , No. 16-70319 (9th Cir. Feb. 2, 2016)   | 6662(b)(1), (2) - TP negligent in failing to maintain records; TP substantially understated income tax; failure to argue reasonable cause and good faith  | No     | IRS      |
| <i>Transupport, Inc. v. Comm'r</i> , T.C. Memo. 2015-179   | 6662(b)(1), (2) - TP negligent in reporting inaccurate amounts on tax return; TP substantially understated income tax; failure to establish reasonable cause and good faith reliance on tax professional        | No     | IRS      |
| <i>Tucker v. Comm'r</i> , T.C. Memo. 2015-185, <i>appeal docketed</i> , No. 16-11042 (11th Cir. Mar. 8, 2016)  | 6662(b)(2) - TP substantially understated income tax; failure to establish reasonable cause and good faith or substantial authority for loss deductions   | No     | IRS      |
| <i>Wagner v. Comm'r</i> , T.C. Memo. 2015-120  | 6662(b)(1), (2) - TP negligent in failing to maintain records and substantially understated income tax; failure to establish reasonable cause and good faith  | Yes    | IRS      |
| <i>Wideman v. Comm'r</i> , T.C. Summ. Op. 2015-61  | 6662(b)(1) - TPs (H&W) negligent in adjustments conceded and disallowed deduction for miscellaneous expenses; TPs not liable for negligence penalty for other deductions  | No     | Split    |
| <i>Wiley M. Elick DDS, Inc. v. Comm'r</i> , 117 A.F.T.R.2d (RIA) 457 (9th Cir. 2016), <i>aff'g</i> T.C. Memo. 2013-139, <i>cert. denied</i> , No. 15-1290 (May 16, 2016) | 6662(b)(1) - TPs (H&W) negligent in failing to make reasonable attempts to ascertain the accuracy of claimed deductions; failure to establish reasonable cause and good faith reliance on tax professional      | No     | IRS      |
| <i>Wright v. Comm'r</i> , 809 F.3d 877 (6th Cir. 2016), <i>rev'd and remanded</i> , T.C. Memo. 2014-175  | 6662(b)(2) - TPs (H&W) not liable for any deficiency and therefore penalties do not apply   | No     | TP       |
| <i>WSK &amp; Sons, Inc. v. Comm'r</i> , T.C. Memo. 2015-204, <i>appeal docketed</i> , No. 16-70772 (9th Cir. Mar. 22, 2016)  | 6662(b)(1) - TP negligent in failing to report income and claiming improper rental expense deductions; failure to argue reasonable cause and good faith reliance on tax professional                            | No     | IRS      |
| <i>Young v. Comm'r</i> , T.C. Memo. 2015-189, <i>appeal dismissed</i> , No. 16-1486 (6th Cir. July 15, 2016)   | 6662(b)(2) - Penalty for substantial understatement of income tax applies provisionally; failure to establish reasonable cause and good faith   | Yes    | IRS      |

**TABLE 2 Appeals From Collection Due Process Hearings Under  
IRC §§ 6320 and 6330**

| Case Citation   | Lien or Levy | Issue(s)   | Pro Se | Decision |
|---|--------------|--|--------|----------|
| Individual Taxpayers (But Not Sole Proprietorships)   |              |  |        |          |
| <i>Abu-Dayeh v. Comm'r</i> , T.C. Memo. 2015-136  | Lien         | No abuse of discretion in rejecting offer; TP did not conform to offer requirements or propose collection alternatives; TP precluded from challenging underlying liability | Yes    | IRS      |
| <i>Alphson v. Comm'r</i> , T.C. Memo. 2016-84   | Lien         | No abuse of discretion in rejecting offer  | No     | IRS      |
| <i>Anyanwu v. Comm'r</i> , T.C. Summ. Op. 2015-56   | Levy         | TP entitled to challenge underlying liabilities  | No     | TP       |
| <i>Bailey v. Comm'r</i> , T. C. Memo. 2016-94   | Lien/Levy    | TP precluded from challenging underlying liability; Collection action was properly sustained   | Yes    | IRS      |
| <i>Baptiste v. Comm'r</i> , T.C. Memo. 2016-4   | Lien         | No abuse of discretion since TP did not provide information requested or participate in hearing; TP precluded from challenging underlying liabilities                      | Yes    | IRS      |
| <i>Bean v. Comm'r</i> , T.C. Summ. Op. 2016-16  | Levy         | No abuse of discretion since TPs (H&W) did not provide information requested for collection alternative  | Yes    | IRS      |
| <i>Berglund v. Comm'r</i> , T.C. Memo. 2015-239   | Lien/Levy    | Collection action was properly sustained; No abuse of discretion   | Yes    | IRS      |
| <i>Bongam v. Comm'r</i> , 146 T.C. 52 (2016)  | Lien         | Court has jurisdiction to review case; IRS motion for summary judgment denied  | Yes    | TP       |
| <i>Boulware v. Comm'r</i> , 816 F.3d 133 (D.C. Cir. 2016), <i>aff'g</i> T.C. Memo. 2014-80                  | Levy         | No abuse of discretion in rejecting installment agreement or denying face-to-face hearing  | No     | IRS      |
| <i>Brown v. Comm'r</i> , T.C. Memo. 2016-82, <i>appeal docketed</i> , No. 16-1255 (D.C. Cir. July 28, 2016) | Lien/Levy    | Collection action was properly sustained   | No     | IRS      |
| <i>Canaday v. Comm'r</i> , T.C. Summ. Op. 2015-57   | Levy         | TP entitled to challenge underlying liabilities; Abuse of discretion by Appeals Officer; Case remanded to Appeals  | Yes    | TP       |
| <i>Chambers v. Comm'r</i> , 606 F. App'x 411 (9th Cir. 2015), <i>aff'g</i> T.C. Memo. 2013-252              | Levy         | TP precluded from challenging underlying liability   | Yes    | IRS      |
| <i>Chandler v. Comm'r</i> , T.C. Memo. 2015-215, <i>aff'd</i> , 2016 U.S. App. LEXIS 17899 (10th Cir. 2016) | Lien         | No abuse of discretion in rejecting offer  | Yes    | IRS      |
| <i>Charnas v. Comm'r</i> , T.C. Memo. 2015-153  | Lien/Levy    | Abuse of discretion by settlement officer; Case remanded to Appeals to consider offer  | Yes    | TP       |
| <i>Crown v. Comm'r</i> , T.C. Summ. Op. 2016-15   | Levy         | No abuse of discretion in sustaining collection action; TP precluded from challenging underlying liability   | Yes    | IRS      |
| <i>Doose v. Comm'r</i> , T.C. Memo. 2016-89   | Levy         | TP precluded from challenging underlying liability; Collection action was properly sustained   | Yes    | IRS      |
| <i>Drew v. Comm'r</i> , T.C. Memo. 2016-97  | Lien/Levy    | No abuse of discretion in declining to withdraw lien or in rejecting offer   | No     | IRS      |
| <i>Drilling v. Comm'r</i> , T.C. Memo. 2016-103   | Lien/Levy    | TP precluded from challenging underlying liability; No abuse of discretion in rejecting offer; Collection action was properly sustained                                    | No     | IRS      |

TABLE 2: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

| Case Citation   | Lien or Levy | Issue(s)  | Pro Se | Decision |
|---|--------------|---|--------|----------|
| <i>Eichinger v. Comm'r</i> , T.C. Summ. Op. 2016-18   | Lien         | TPs (H&W) entitled to challenge underlying liability; TPs not entitled to a dependency exemption  | Yes    | IRS      |
| <i>Friedman v. Comm'r</i> , T.C. Memo. 2015-196   | Lien/Levy    | No abuse of discretion; TPs (H&W) did not offer a collection alternative  | Yes    | IRS      |
| <i>Gafford v. Comm'r</i> , T.C. Memo. 2016-40   | Levy         | Court lacks jurisdiction to review; TP did not timely request hearing   | Yes    | IRS      |
| <i>Gardner v. Comm'r</i> , 145 T.C. 161 (2015), appeal docketed, No. 15-72852 (9th Cir. Sep. 15, 2015)              | Lien/Levy    | No abuse of discretion; TPs (H&W) responsible for the underlying liability  | Yes    | IRS      |
| <i>Gardner v. Comm'r</i> , T.C. Summ. Op. 2015-43   | Levy         | No abuse of discretion since TP did not provide information requested; TP precluded from challenging underlying liability                                     | Yes    | IRS      |
| <i>Grauer v. Comm'r</i> , T.C. Memo. 2016-52  | Levy         | Statute of limitations had run prior to IRS issuing TP levy notice  | Yes    | TP       |
| <i>Green v. Comm'r</i> , 608 F. App'x 671 (10th Cir. 2015)  | Lien         | TP precluded from challenging liability; Collection action was properly sustained   | Yes    | IRS      |
| <i>Greenberg v. Comm'r</i> , 2015 U.S. App. LEXIS 11391 (D.C. Cir. 2015)  | Lien         | Collection action was properly sustained  | Yes    | IRS      |
| <i>Haddix v. Comm'r</i> , T.C. Memo. 2015-220, appeal docketed, No. 16-60115 (5th Cir. Feb. 29, 2016)               | Levy         | Court lacks jurisdiction to review  | Yes    | IRS      |
| <i>Hare v. Comm'r</i> , T.C. Memo. 2015-250   | Lien         | No abuse of discretion; TP made frivolous arguments   | Yes    | IRS      |
| <i>Hartmann v. Comm'r</i> , T.C. Memo. 2015-129, <i>aff'd</i> , 2016 U.S. App. LEXIS 13376 (3d Cir. 2016)           | Levy         | No abuse of discretion in denying collection alternative since TP did not provide the information requested   | Yes    | IRS      |
| <i>Hawkins v. Comm'r</i> , T.C. Memo. 2015-245  | Levy         | No abuse of discretion since TP did not provide information requested; Collection action was properly sustained   | Yes    | IRS      |
| <i>Hawthorne v. Comm'r</i> , T.C. Memo. 2015-148  | Lien         | No abuse of discretion  | Yes    | IRS      |
| <i>Holdner v. Comm'r</i> , 623 F. App'x 892 (9th Cir. 2015)   | Lien/Levy    | TP precluded from challenging underlying liability; Collection action was properly sustained  | Yes    | IRS      |
| <i>Howell v. Comm'r</i> , T.C. Summ. Op. 2015-45  | Levy         | No abuse of discretion  | Yes    | IRS      |
| <i>Jeanmarie v. Comm'r</i> , 648 F. App'x 448 (5th Cir. 2016), <i>aff'g</i> T.C. docket No. 25533-13 (Oct. 3, 2014) | Levy         | No abuse of discretion in denying face-to-face hearing; TPs (H&W) not entitled to collection alternative; TPs precluded from challenging underlying liability | Yes    | IRS      |
| <i>Kakeh v. Comm'r</i> , T.C. Memo. 2015-103  | Lien         | No abuse of discretion in rejecting offer; TPs (H&W) responsible for underlying liability   | No     | IRS      |
| <i>Kanofsky v. Comm'r</i> , 618 F. App'x 48 (3d Cir. 2015), <i>aff'g</i> T.C. Memo. 2014-153                        | Lien         | TP precluded from challenging underlying liabilities; No abuse of discretion; TP made frivolous arguments   | Yes    | IRS      |
| <i>Krishnan v. Comm'r</i> , T.C. Memo. 2016-83  | Lien         | No abuse of discretion; Collection action was properly sustained  | Yes    | IRS      |



TABLE 2: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

| Case Citation  | Lien or Levy | Issue(s)  | Pro Se | Decision |
|--|--------------|---|--------|----------|
| <i>La Sala, Estate of, v. Comm’r</i> , T.C. Memo. 2016-42, <i>appeal dismissed</i> , No. 16-1820 (2d Cir. Aug. 12, 2016) | Lien         | Collection action was properly sustained  | No     | IRS      |
| <i>Lovely v. Comm’r</i> , T.C. Memo. 2015-135, <i>aff’d</i> , 642 F. App’x 268 (4th Cir. 2016)                           | Levy         | No abuse of discretion; TP made frivolous arguments   | Yes    | IRS      |
| <i>Martens v. Comm’r</i> , T.C. Memo. 2015-213   | Lien/Levy    | No abuse of discretion in sustaining collection action; TP precluded from challenging underlying income tax liability; TP is entitled to challenge frivolous return penalty | Yes    | Split    |
| <i>Mathews v. Comm’r</i> , T.C. Memo. 2015-225   | Lien         | No abuse of discretion; collection action was properly sustained  | No     | IRS      |
| <i>McLeod v. Comm’r</i> , T.C. Memo. 2016-14   | Levy         | TPs (H&W) precluded from challenging underlying liability; No abuse of discretion in rejecting offer  | Yes    | IRS      |
| <i>McRae v. Comm’r</i> , T.C. Memo. 2015-132   | Lien         | No abuse of discretion in denying collection alternative since TP did not provide the information requested; No abuse of discretion in denying face-to-face hearing         | Yes    | IRS      |
| <i>Miller v. Comm’r</i> , T.C. Memo. 2016-73   | Levy         | No abuse of discretion  | No     | IRS      |
| <i>Morris v. Comm’r</i> , T.C. Memo. 2016-16   | Lien/Levy    | Collection action was properly sustained  | Yes    | IRS      |
| <i>Myers v. Comm’r</i> , 630 F. App’x 207 (4th Cir. 2016)  | Levy         | No abuse of discretion; TP made frivolous arguments   | Yes    | IRS      |
| <i>Natkunanathan v. Comm’r</i> , T.C. Memo. 2015-106, <i>appeal docketed</i> , No. 15-73334 (9th Cir. Oct. 30, 2015)     | Levy         | No abuse of discretion since TP did not participate in hearing; IRS motion for summary judgment granted   | Yes    | IRS      |
| <i>Norman v. Comm’r</i> , T.C. Memo. 2016-98   | Levy         | No abuse of discretion; Collection action was properly sustained  | Yes    | IRS      |
| <i>Ogamba v. Comm’r</i> , T.C. Memo. 2016-105  | Levy         | TPs (H&W) entitled to challenge underlying income tax liabilities; TP precluded from challenging penalties or additions to tax  | Yes    | Split    |
| <i>Onyango v. Comm’r</i> , 638 F. App’x 5 (D.C. Cir. 2016), <i>aff’g</i> 142 T.C. 425 (2014)                             | Lien         | No abuse of discretion; TP precluded from challenging underlying liabilities  | Yes    | IRS      |
| <i>Pansier v. Comm’r</i> , 623 F. App’x 809 (7th Cir. 2015), <i>aff’g</i> T.C. Memo 2014-255                             | Levy         | No abuse of discretion; TP (H&W) made frivolous arguments   | Yes    | IRS      |
| <i>Peterson v. Comm’r</i> , T.C. Memo. 2016-17   | Lien         | IRS failed to establish notices of deficiencies were mailed to TP; Case remanded to Appeals   | Yes    | TP       |
| <i>Powers v. Comm’r</i> , T.C. Memo. 2015-210  | Lien/Levy    | No abuse of discretion in denying collection alternative since TP did not provide information requested or participate in hearing   | Yes    | IRS      |
| <i>Rebuck v. Comm’r</i> , T.C. Memo. 2016-3  | Levy         | No abuse of discretion in rejecting offer; Collection action was properly sustained   | No     | IRS      |
| <i>Rehn v. Comm’r</i> , T.C. Memo. 2016-54   | Lien/Levy    | No abuse of discretion in denying face-to-face hearing; Collection action was properly sustained  | No     | IRS      |
| <i>Riley v. Comm’r</i> , T.C. Memo. 2016-46  | Lien         | TP entitled to challenge underlying liabilities; TP could not establish theft loss deduction  | No     | Split    |
| <i>Rodrigues v. Comm’r</i> , T.C. Memo. 2015-178   | Lien         | No abuse of discretion  | Yes    | IRS      |

TABLE 2: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

| Case Citation  | Lien or Levy | Issue(s)   | Pro Se | Decision |
|--|--------------|--|--------|----------|
| <i>Ryskamp v. Comm’r</i> , 797 F.3d 1142 (D.C. Cir. 2015), <i>cert. denied</i> , 136 U.S. 834 (2016)           | Levy         | Collection action was properly sustained; No abuse of discretion   | No     | IRS      |
| <i>Schlegel v. Comm’r</i> , T.C. Memo. 2016-90, <i>appeal docketed</i> , No. 16-3622 (8th Cir. Sept. 14, 2016) | Levy         | TP precluded from challenging underlying liability; No abuse of discretion in denying face-to-face hearing                                       | Yes    | IRS      |
| <i>Schumacher v. Comm’r</i> , T.C. Memo. 2015-166  | Lien         | No abuse of discretion in declining to withdraw lien   | Yes    | IRS      |
| <i>Scott v. Comm’r</i> , T.C. Memo. 2015-180   | Levy         | No abuse of discretion in granting installment agreement and denying “currently-not-collectible” status  | No     | IRS      |
| <i>Seipel v. Comm’r</i> , T.C. Memo. 2015-154, <i>appeal dismissed</i> , No. 15-73242 (9th Cir. Apr. 12, 2016) | Lien         | Collection action was properly sustained   | Yes    | IRS      |
| <i>Shenk v. Comm’r</i> , T.C. Memo. 2015-193   | Lien         | No abuse of discretion in declining to withdraw lien   | Yes    | IRS      |
| <i>Silva v. Comm’r</i> , T.C. Memo. 2015-229   | Lien         | No abuse of discretion in denying face-to-face hearing; TP not entitled to collection alternative  | Yes    | IRS      |
| <i>Stanley v. Comm’r</i> , T.C. Memo. 2016-26  | Lien/Levy    | TPs (H&W) precluded from challenging underlying liability; Collection action properly sustained; TP’s made frivolous arguments                   | Yes    | IRS      |
| <i>Taylor v. Comm’r</i> , T.C. Memo. 2016-81   | Levy         | Court lacked jurisdiction to review  | Yes    | IRS      |
| <i>Terry v. Comm’r</i> , T.C. Memo. 2016-88  | Levy         | No abuse of discretion in denying a face-to-face hearing; No abuse of discretion in denying collection alternatives                              | Yes    | IRS      |
| <i>Thomas v. Comm’r</i> , T.C. Memo. 2015-182  | Levy         | No abuse of discretion in rejecting offer  | No     | IRS      |
| <i>Tillery v. Comm’r</i> , T.C. Memo. 2015-170   | Levy         | No abuse of discretion in rejecting installment agreement and sustaining collection action   | No     | IRS      |
| <i>Trumbly v. Comm’r</i> , T.C. Memo. 2015-207   | Lien         | TPs (H&W) filed for bankruptcy after petitioning tax court; Review of lien filing moot since bankruptcy court discharged tax liability           | No     | TP       |
| <i>Walker v. Comm’r</i> , T. C. Memo. 2016-75  | Levy         | Collection action was properly sustained   | No     | IRS      |
| <i>Waltner v. Comm’r</i> , T.C. Memo. 2015-146, <i>appeal docketed</i> , No. 16-71797 (9th Cir. June 7, 2016)  | Levy         | TPs (H&W) precluded from challenging underlying liability; No abuse of discretion in denying face-to-face hearing; TP’s made frivolous arguments | Yes    | IRS      |
| <i>Widtfeldt v. U.S.</i> , 641 F. App’x 637 (8th Cir. 2016)  | Lien         | TP precluded from challenging underlying liability   | Yes    | IRS      |
| <i>Wills v. Comm’r</i> , T.C. Summ. Op. 2015-50  | Levy         | No abuse of discretion; Collection action was properly sustained   | No     | IRS      |
| <i>Willson v. Comm’r</i> , 805 F.3d 316 (D.C. Cir. 2015)   | Levy         | No jurisdiction to refund TP money paid to IRS during proceedings  | Yes    | IRS      |
| <i>Yasgur v. Comm’r</i> , T.C. Memo. 2016-77   | Lien/Levy    | TP entitled to challenge underlying liability since TP did not receive levy notice; Case remanded to Appeals                                     | No     | TP       |
| <i>York v. Comm’r</i> , T.C. Memo. 2015-159  | Lien         | No abuse of discretion in rejecting offer  | Yes    | IRS      |
| <i>Zepeda v. Comm’r</i> , 116 A.F.T.R.2d (RIA) 6919 (9th Cir. 2015), <i>aff’g</i> T.C. docket No. 9552-11      | Lien         | TP precluded from challenging underlying liability; Collection action was properly sustained   | Yes    | IRS      |

TABLE 2: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

| Case Citation   | Lien or Levy | Issue(s)  | Pro Se | Decision |
|---|--------------|---|--------|----------|
| Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedule C, E, F)                  |              |   |        |          |
| <i>Au v. Comm’r</i> , T.C. Memo. 2015-183   | Lien         | No abuse of discretion in rejecting offer since TP did not provide information requested; No abuse of discretion in denying face-to-face hearing; TP precluded from raising issue not properly raised during CDP          | Yes    | IRS      |
| <i>Bishay v. Comm’r</i> , T.C. Memo. 2015-105, <i>appeal docketed</i> , No. 15-2040 (1st Cir. Sept. 21, 2015)         | Lien         | TP precluded from challenging underlying liability; No abuse of discretion; Collection action was properly sustained  | Yes    | IRS      |
| <i>Clues v. Comm’r</i> , T.C. Memo. 2015-209  | Lien/Levy    | No abuse of discretion in denying “currently-not-collectible” status  | Yes    | IRS      |
| <i>Del-Co Western v. Comm’r</i> , T.C. Memo. 2015-142   | Levy         | Court lacks jurisdiction to review  | No     | IRS      |
| <i>Epitome Sys. v. Comm’r</i> , T.C. Memo. 2015-108   | Levy         | No abuse of discretion since TP did not provide information requested; TP made frivolous arguments  | Yes    | IRS      |
| <i>Haben v. Comm’r</i> , T.C. Summ. Op. 2015-55   | Levy         | No abuse of discretion since TP did not provide information requested for collection alternative; TP precluded from challenging underlying liability  | Yes    | IRS      |
| <i>Hampton Software Develop. v. Comm’r</i> , T.C. Memo. 2016-38   | Levy         | TP entitled to challenge underlying liabilities; IRS motion for summary judgment denied   | No     | TP       |
| <i>John C. Hom &amp; Assocs. v. Comm’r</i> , T.C. Summ. Op. 2015-49   | Lien         | TP entitled to challenge underlying liabilities   | Yes    | TP       |
| <i>LG Kendrick, LLC v. Comm’r</i> , 146 T.C. 17 (2016), <i>appeal docketed</i> , No. 16-9003 (10th Cir. May 23, 2016) | Lien/Levy    | Court lacks jurisdiction to review lien filing for December 31, 2010, Form 941 liability; TP precluded from challenging underlying liability; Collection action was properly sustained for periods court had jurisdiction | No     | Split    |
| <i>LG Kendrick, LLC v. Comm’r</i> , T.C. Memo. 2016-22, <i>appeal docketed</i> , No. 16-9003 (10th Cir. May 23, 2016) | Lien/Levy    | No abuse of discretion in sustaining collection action; TP precluded from challenging underlying liability  | No     | IRS      |
| <i>Lunnon v. Comm’r</i> , T.C. Memo. 2015-156, <i>aff’d by</i> 117 A.F.T.R.2d (RIA) 2094 (10th Cir. 2016)             | Lien/Levy    | No abuse of discretion; TP precluded from challenging underlying liability  | Yes    | IRS      |
| <i>Mangum v. Comm’r</i> , T.C. Memo. 2016-24  | Lien         | TPs (H&W) precluded from challenging underlying liability; No abuse of discretion in rejecting offer; Collection action properly sustained  | No     | IRS      |
| <i>Miccosukee Tribe of Indians of Florida v. Comm’r</i> , T.C. Memo. 2015-216   | Lien/Levy    | No abuse of discretion in denying collection alternative or declining to withdraw lien  | No     | IRS      |
| <i>Nutrition Formulators v. Comm’r</i> , T.C. Memo. 2016-60   | Lien/Levy    | No abuse of discretion in declining to withdraw lien; Collection action was properly sustained  | No     | IRS      |
| <i>Obiakor v. Comm’r</i> , T.C. Memo. 2015-112  | Levy         | No abuse of discretion in denying collection alternative  | No     | IRS      |
| <i>Quality Software Sys. v. Comm’r</i> , T.C. Memo. 2015-107  | Lien         | No abuse of discretion in denying reinstatement of offer; IRS deprived tax court of opportunity for judicial review; Case remanded to Appeals to determine basis for rejection of collection alternative                  | No     | Split    |
| <i>Raida v. Comm’r</i> , T.C. Memo. 2015-242  | Levy         | No abuse of discretion in rejecting offer; Collection action was properly sustained   | Yes    | IRS      |

TABLE 2: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

| Case Citation  | Lien or Levy | Issue(s)  | Pro Se | Decision |
|--|--------------|---|--------|----------|
| <i>Scott Labor, LLC v. Comm'r</i> , T.C. Memo. 2015-194  | Levy         | Court had jurisdiction to review underlying liability; TP responsible for employment taxes and failure to pay penalty; Intentional disregard and failure to file penalties were inappropriate | No     | Split    |
| <i>Strong v. Comm'r</i> , T.C. Memo. 2016-70   | Levy         | No abuse of discretion in rejecting offer; Collection action was properly sustained   | No     | IRS      |
| <i>Synergy Environmental v. Comm'r</i> , T.C. Memo. 2016-99, <i>appeal docketed</i> , No. 16-72615 (9th Cir. Aug. 5, 2016) | Lien         | No abuse of discretion in rejecting offer; Collection action was properly sustained   | No     | IRS      |
| <i>Wilson Heirs Trust v. Comm'r</i> , T. C. Memo. 2016-76  | Lien/Levy    | No abuse of discretion  | Yes    | IRS      |

**TABLE 3 Summons Enforcement Under IRC §§ 7602, 7604, and 7609**

| Case Citation  | Issue(s)   | Pro Se | Decision |
|--|--|--------|----------|
| <b>Individual Taxpayers (But Not Sole Proprietorships)</b>   |  |        |          |
| <i>Allen, U.S. v.</i> , 2015 U.S. Dist. LEXIS 148002 (W.D. Mich. 2015), adopting 2015 U.S. Dist. LEXIS 148754 (W.D. Mich. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Allen, U.S. v.</i> , 2015 U.S. Dist. LEXIS 148008 (W.D. Mich. 2015), adopting 2015 U.S. Dist. LEXIS 148756 (W.D. Mich. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Allen, U.S. v.</i> , 2015 U.S. Dist. LEXIS 148006 (W.D. Mich. 2015), adopting 2015 U.S. Dist. LEXIS 148759 (W.D. Mich. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Allen, U.S. v.</i> , 2015 U.S. Dist. LEXIS 148009 (W.D. Mich. 2015), adopting 2015 U.S. Dist. LEXIS 148758 (W.D. Mich. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Allen, U.S. v.</i> , 2015 U.S. Dist. LEXIS 148007 (W.D. Mich. 2015), adopting 2015 U.S. Dist. LEXIS 148757 (W.D. Mich. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Anderson, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1174 (N.D. Cal. 2016)  | TP held in contempt  | No     | IRS      |
| <i>Archer, U.S. v.</i> , 2016 U.S. Dist. LEXIS 50297 (S.D. Miss. 2016), adopting 2016 U.S. Dist. LEXIS 51152 (S.D. Miss. 2016)   | Summons enforced   | Yes    | IRS      |
| <i>Awar, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 702 (D. Ariz. 2016)  | Summons enforced   | No     | IRS      |
| <i>Baxter v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1253 (N.D. Cal. 2016), modifying 117 A.F.T.R.2d (RIA) 694 (N.D. Cal. 2016), appeal docketed, No. 16-16021 (9th Cir. June 7, 2016)   | Court did not have the authority to order the IRS to meet and confer with TPs prior to resubmission of the summons and did not have jurisdiction to order <i>in camera</i> review; IRS did not provide adequate advance notice to the TP that it would contact a third party | No     | Split    |
| <i>Baxter v. U.S.</i> , 117 A.F.T.R.2d (RIA) 694 (N.D. Cal. 2016), modified by 117 A.F.T.R.2d (RIA) 1253 (N.D. Cal. 2016), appeal docketed, No. 16-16021 (9th Cir. June 7, 2016) | TP's motion to quash third party summons granted for 2011 as IRS did not provide sufficient notice to TPs that it would contact a third party; Lack of subject matter jurisdiction for 2012  | No     | Split    |
| <i>Belcik, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 926 (M.D. Fla. 2016), adopting in part 117 A.F.T.R.2d (RIA) 922 (M.D. Fla. 2016)   | TP held in contempt  | Yes    | IRS      |
| <i>Bellamy, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1905 (E.D. Pa. 2016)  | Summons enforced   | Yes    | IRS      |
| <i>Bess, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6606 (N.D. Cal. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Billie, U.S. v.</i> , 611 F. App'x. 608 (11th Cir. 2015), <i>aff'g</i> 114 A.F.T.R.2d (RIA) 5694 (S.D. Fla. 2014)   | Summons enforced as it does not implicate Indian Tribal Government sovereign immunity  | No     | IRS      |
| <i>Blamires, U.S. v.</i> , 2016 U.S. Dist. LEXIS 4989 (D. Utah 2016), adopting 117 A.F.T.R.2d (RIA) 454 (D. Utah 2015)   | Summons enforced   | Yes    | IRS      |
| <i>Butler, U.S. v.</i> , 2016 U.S. Dist. LEXIS 59179 (W.D. Ky. 2016)   | Summons enforced; TP held in contempt  | No     | IRS      |
| <i>Chapin v. Blair</i> , 117 A.F.T.R.2d (RIA) 570 (D. Idaho 2016), adopting 117 A.F.T.R.2d (RIA) 563 (D. Idaho 2016)   | TP's petition to quash third-party summons denied; Lack of subject matter jurisdiction   | No     | IRS      |
| <i>Chapin v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6062 (D. Idaho 2015), adopting in part and rejecting in part 116 A.F.T.R.2d (RIA) 6055 (D. Idaho 2015)                              | TP's motion to quash third-party summons denied; Magistrate judge's recommendation to limit the summons to certain payroll information not adopted   | No     | IRS      |
| <i>Chen v. U.S.</i> , 115 A.F.T.R.2d (RIA) 2032 (C.D. Cal. 2015), adopting 115 A.F.T.R.2d (RIA) 2029 (C.D. Cal. 2015)  | Summons enforced; TP's petition to quash third-party summons denied  | No     | IRS      |
| <i>Chen v. U.S.</i> , 115 A.F.T.R.2d (RIA) 2352 (C.D. Cal. 2015), adopting 115 A.F.T.R.2d (RIA) 2347 (C.D. Cal. 2015)  | Summons enforced; TP's petition to quash third-party summons denied  | No     | IRS      |

TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

| Case Citation   | Issue(s)  | Pro Se | Decision |
|---|---|--------|----------|
| <i>Chen, U.S. v.</i> , 815 F.3d 72 (1st Cir. 2016), <i>aff'g in part, vacating in part, and remanding</i> 952 F. Supp. 2d 321 (D. Mass. 2013)   | Summons enforced with regard to documents required under Bank Secrecy Act; Case was vacated and remanded with regard to other documents | No     | Split    |
| <i>Clower v. U.S.</i> , 116 A.F.T.R.2d (RIA) 7097 (N.D. Ga. 2015), <i>appeal dismissed</i> , No. 15-15774 (11th Cir. May 4, 2016)   | TP's petition to quash denied; Lack of subject matter jurisdiction  | No     | IRS      |
| <i>Clower, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1446 (N.D. Ga. 2016), <i>adopting</i> 117 A.F.T.R.2d (RIA) 1443 (N.D. Ga. 2016), <i>appeal docketed</i> , No. 16-13039 (11th Cir. May 25, 2016) | Summons enforced  | Yes    | IRS      |
| <i>Curtis, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6525 (N.D. Fla. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6524 (N.D. Fla. 2015)   | Summons enforced  | Yes    | IRS      |
| <i>Deng v. U.S.</i> , 115 A.F.T.R.2d (RIA) 2225 (D. Del. 2015)  | TP's petition to quash third-party summons denied   | No     | IRS      |
| <i>Duncan, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 778 (E.D. La. 2016), <i>adopting</i> 117 A.F.T.R.2d (RIA) 777 (E.D. La. 2016)   | Summons enforced  | Yes    | IRS      |
| <i>Ellis v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6810 (S.D. Miss. 2015)  | Summons enforced; TP's petition to quash denied   | No     | IRS      |
| <i>Gandrup v. U.S.</i> , 115 A.F.T.R.2d (RIA) 2049 (D. Del. 2015)   | TP's petition to quash third-party summons denied   | Yes    | IRS      |
| <i>Gangi v. U.S.</i> , 638 F. App'x 16 (1st Cir. 2016), <i>aff'g</i> 2 F. Supp. 3d 12 (D. Mass. 2014)   | TP's motion to quash third party summons denied   | No     | IRS      |
| <i>Gonzalez, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6644 (S.D. Fla. 2015)   | Summons enforced  | No     | IRS      |
| <i>Grabowski, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6820 (M.D. Fla. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6819 (M.D. Fla. 2015)  | Summons enforced  | Yes    | IRS      |
| <i>Grell, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6405 (D. Minn. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6402 (D. Minn. 2015)  | Summons enforced  | Yes    | IRS      |
| <i>Haber v. U.S.</i> , 115 A.F.T.R.2d (RIA) 2221 (S.D.N.Y. 2015), <i>aff'd</i> 117 A.F.T.R.2d (RIA) 1795 (2d Cir. 2016)   | TP's petition to quash third-party summons denied; Lack of subject matter jurisdiction  | No     | IRS      |
| <i>Haber v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1795 (2d Cir. 2016), <i>aff'g</i> 115 A.F.T.R.2d (RIA) 2221 (S.D.N.Y. 2015)   | TP's petition to quash third-party summons denied; Lack of subject matter jurisdiction  | No     | IRS      |
| <i>Halajian, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 7133 (E.D. Cal. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6901 (E.D. Cal. 2015)   | Summons enforced  | Yes    | IRS      |
| <i>Harrell, U.S. v.</i> , 2015 U.S. Dist. LEXIS 158289 (M.D.N.C. 2015), <i>adopting</i> 2015 U.S. Dist. LEXIS 158565 (M.D.N.C. 2015)  | Summons enforced  | Yes    | IRS      |
| <i>Hayes, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6440 (C.D. Cal. 2015)  | Summons enforced  | Yes    | IRS      |
| <i>In re Sullivan</i> , 610 F. App'x 286 (4th Cir. 2015), <i>aff'g</i> 1165 A.F.T.R.2d (RIA) 1175 (E.D.N.C. 2015), <i>cert. denied</i> , 136 S. Ct. 2026 (2016)                               | Summons enforced  | Yes    | IRS      |
| <i>Kaebel v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6935 (N.D. Tex. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6933 (N.D. Tex. 2015)  | TPs' petition to quash third-party summons denied; Lack of subject matter jurisdiction  | Yes    | IRS      |
| <i>Kaebel, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6051 (E.D. Tex. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6050 (E.D. Tex. 2015)   | Summons enforced; TP's Fifth Amendment claim denied   | Yes    | IRS      |
| <i>Kaemmerer, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6284 (S.D. Ill. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6282 (S.D. Ill. 2015)  | Summons enforced  | Yes    | IRS      |
| <i>Kan v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1764 (C.D. Cal. 2016), <i>partially vacated by</i> docket No. 16-02414 (C.D. Cal. July 19, 2016)  | TP's petition to quash third-party summons granted for 2012 but denied for 2013   | Yes    | Split    |
| <i>Keval, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1244 (E.D. Okla. 2015)   | Summons enforced  | Yes    | IRS      |



TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

| Case Citation   | Issue(s)   | Pro Se | Decision |
|---|--|--------|----------|
| <i>Kirton, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 437 (E.D. Pa. 2015), dismissed by 2016 U.S. Dist. LEXIS 11126 (E.D. Pa. 2016)   | Summons enforced   | Yes    | IRS      |
| <i>Lee, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5387 (D. Nev. 2015), <i>aff'g</i> 116 A.F.T.R.2d (RIA) 5386 (D. Nev. 2014), <i>appeal docketed</i> , No. 15-16869 (9th Cir. Sept. 21, 2015)                                      | TP's motion for reconsideration to reverse case dismissal was denied   | No     | IRS      |
| <i>Lonnen, U.S. v.</i> , 118 A.F.T.R.2d (RIA) 5430 (M.D.N.C. 2016), <i>adopting</i> 116 A.F.T.R.2d (RIA) 7119 (M.D.N.C. 2015)   | Summons enforced   | Yes    | IRS      |
| <i>Maeher v. Comm'r</i> , 116 A.F.T.R.2d (RIA) 5398 (D. Colo. 2015), <i>aff'd</i> by 117 A.F.T.R.2d (RIA) 658 (10th Cir. 2016)  | IRS was not required to give TP notice of third-party summons; District court lacked subject matter jurisdiction | Yes    | IRS      |
| <i>Maeher v. Comm'r</i> , 117 A.F.T.R.2d (RIA) 658 (10th Cir. 2016), <i>aff'g</i> 116 A.F.T.R.2d (RIA) 5398 (D. Colo. 2015)   | TPs' motion to quash third-party summons denied; Lack of subject matter jurisdiction                             | Yes    | IRS      |
| <i>Malhas, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6724 (N.D. Ill. 2015)   | Summons enforced   | No     | IRS      |
| <i>McIndoo v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1381 (C.D. Cal. 2016), <i>adopting</i> 117 A.F.T.R.2d (RIA) 1378 (C.D. Cal. 2016)   | TP's motion to quash third-party summons denied  | No     | IRS      |
| <i>Moore, U.S. v.</i> , 2016 U.S. Dist. LEXIS 13941 (D. Me. 2016), <i>adopting</i> 2016 U.S. Dist. LEXIS 5454 (D. Me. 2016)   | Summons enforced   | Yes    | IRS      |
| <i>Moscoco, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 7014 (S.D. Cal. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Ottimo, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 964 (S.D. Fla. 2016)  | Summons enforced   | Yes    | IRS      |
| <i>Pendergrass, U.S. v.</i> , 2016 U.S. Dist. LEXIS 50775 (W.D. Mo. 2016), <i>adopting</i> 2016 U.S. Dist. LEXIS 51501 (W.D. Mo. 2016)  | Summons enforced   | Yes    | IRS      |
| <i>Petchauer, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1378 (W.D. Mich. 2016), <i>adopting</i> 117 A.F.T.R.2d (RIA) 1377 (W.D. Mich. 2016)  | Summons enforced   | Yes    | IRS      |
| <i>Phipps, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 987 (D. Vt. 2016)   | Summons enforced   | Yes    | IRS      |
| <i>Randolph, U.S. v.</i> , 2015 U.S. Dist. LEXIS 159181 (M.D.N.C. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6647 (M.D.N.C. 2015)  | Summons enforced   | Yes    | IRS      |
| <i>Rexrode, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6046 (E.D. Tex. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 5983 (E.D. Tex. 2015)  | Summons enforced; TP's Fifth Amendment claim denied  | Yes    | IRS      |
| <i>Robb, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6508 (S.D. Ohio 2015)   | Summons enforced   | Yes    | IRS      |
| <i>Samango, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1320 (E.D. Pa. 2016)   | Summons enforced; TP's motion to quash denied  | Yes    | IRS      |
| <i>Singh, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5313 (E.D. Cal. 2015), <i>adopting</i> 115 A.F.T.R.2d (RIA) 1934 (E.D. Cal. 2015), <i>order enforced</i> by 117 A.F.T.R.2d (RIA) 1069 (E.D. Cal. 2016)                         | Summons enforced; TP's request for recusal denied  | Yes    | IRS      |
| <i>Singh, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1069 (E.D. Cal. 2016), <i>enforcing</i> 116 A.F.T.R.2d (RIA) 5313 (E.D. Cal. 2015)   | TP held in contempt  | Yes    | IRS      |
| <i>Siron, U.S. v.</i> , 2015 U.S. Dist. LEXIS 169310 (D.S.C. 2015)  | Summons enforced; Bench warrant lifted   | Yes    | IRS      |
| <i>Soong, U.S. v.</i> , 116 A.F.T.R.2d 5792 (N.D. Cal. 2015), <i>granting motion for civil contempt sanctions</i> , 113 A.F.T.R.2d (RIA) 1589 (N.D. Cal. 2014), <i>aff'd</i> by 117 A.F.T.R.2d (RIA) 1801 (9th Cir. 2016)   | TPs held in contempt   | No     | IRS      |
| <i>Soong, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1801 (9th Cir. 2016), <i>aff'g</i> 113 A.F.T.R.2d (RIA) 1589 (N.D. Cal. 2014), <i>motion for civil contempt sanctions granted</i> , 116 A.F.T.R.2d (RIA) 5792 (N.D. Cal. 2015) | Summons enforced; TPs' motion to dismiss summons on the basis of insufficient service of process denied          | No     | IRS      |
| <i>Stadmueller v. U.S.</i> , 116 A.F.T.R.2d (RIA) 5648 (C.D. Cal. 2015)   | TP's motion to quash third party summons denied  | No     | IRS      |
| <i>Stenshoel-Sousa v. U.S.</i> , 118 A.F.T.R.2d (RIA) 5632 (N.D. Cal. 2016), <i>adopting</i> 118 A.F.T.R.2d (RIA) 5628 (N.D. Cal. 2016)   | TP's motion to quash third party summons denied for lack of standing and lack of subject matter jurisdiction     | No     | IRS      |

TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

| Case Citation   | Issue(s)   | Pro Se | Decision |
|---|--|--------|----------|
| <i>Thornton, U.S. v.</i> , 621 F. App'x. 360 (8th Cir. 2015), <i>aff'g</i> 115 A.F.T.R.2d (RIA) 1258 (D. Minn. 2015), <i>cert. denied</i> , 136 S. Ct. 2424 (2016)  | Summons enforced; TP held in contempt  | Yes    | IRS      |
| <i>Tweedy, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 945 (E.D. Va. 2015)   | Summons enforced   | Yes    | IRS      |
| <i>Witt, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5060 (E.D. Cal. 2015), <i>adopting</i> 115 A.F.T.R.2d (RIA) 2042 (E.D. Cal. 2015), <i>appeal docketed</i> , No. 15-16721 (9th Cir. Aug. 31, 2015)   | Summons enforced   | Yes    | IRS      |
| <i>Wood v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1919 (D. Md. 2016)   | Summons enforced; TP's petition to quash third-party summons denied  | Yes    | IRS      |
| <i>Zwaal, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 327 (N.D. Cal. 2015), <i>adopting</i> 117 A.F.T.R.2d (RIA) 325 (N.D. Cal. 2015)  | Summons enforced   | Yes    | IRS      |
| <b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships- Schedules C, E, F)</b>   |  |        |          |
| <i>Chabot, U.S. v.</i> , 793 F.3d 338 (3d Cir. 2015), <i>aff'g</i> 114 A.F.T.R.2d (RIA) 6235 (D.N.J.), <i>cert. denied</i> , 136 S. Ct. 559 (2015)  | Summons enforced; Required records doctrine supercedes TP's Fifth Amendment claim  | No     | IRS      |
| <i>Clarke, U.S. v.</i> , 816 F. 3d 1310 (11th Cir. 2016), <i>aff'g</i> 115 A.F.T.R.2d (RIA) 836 (S.D. Fla. 2015), <i>on remand from</i> 573 F. App'x 826 (11th Cir. 2014), <i>on remand from</i> 134 S. Ct. 2361 (2014), <i>vacating and remanding</i> 517 F. App'x 689 (11th Cir. 2013), <i>petition for cert. filed</i> , No. 16-358 (Sept. 19, 2016) | Summons enforced and evidentiary hearing denied as TPs failed to point to IRS's bad faith or improper motive   | No     | IRS      |
| <i>Davis &amp; Campbell, LLC v. U.S.</i> , 116 A.F.T.R.2d (RIA) 7124 (S.D.N.Y. 2015)  | TP's motion to quash third-party summons denied  | No     | IRS      |
| <i>Highland Capital Mgmt., L.P. v. U.S.</i> , 626 F. App'x 324 (2d Cir. 2015), <i>aff'g in part, vacating in part, and remanding in part</i> 51 F. Supp. 3d 544 (S.D.N.Y. 2014)   | TP's motion to quash third-party summons for lack of notice or bad faith denied; Case remanded to determine whether summoned information is privileged | No     | Split    |
| <i>HP Distrib., LLC v. U.S.</i> , 115 A.F.T.R.2d (RIA) 2028 (D. Kan. 2015), <i>adopting</i> 115 A.F.T.R.2d (RIA) 2024 (D. Kan. 2015)  | Summons enforced; TP's petition to quash third-party summons denied; Lack of subject matter jurisdiction   | No     | IRS      |
| <i>Lamotte, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1725 (D. Mass. 2016), <i>adopting</i> 117 A.F.T.R.2d (RIA) 1718 (D. Mass. 2016), <i>appeal dismissed</i> , No. 16-1940 (1st Cir. Aug. 2, 2016)   | Summonses dismissed as IRS already had possession of summoned documents and TP entitled to Fifth Amendment privilege for testimony                     | No     | TP       |
| <i>Masciantonio v. U.S.</i> , 647 F. App'x 108 (3d Cir. 2016), <i>aff'g</i> 114 A.F.T.R.2d (RIA) 7010 (W.D. Pa. 2014)   | Summons enforced; TP's petition to quash denied  | Yes    | IRS      |
| <i>Microsoft Corp., U.S. v.</i> , 116 A.F.T.R.2d (RIA) 2186 (W.D. Wash. 2015)   | TP's motion for evidentiary hearing granted  | No     | TP       |
| <i>Microsoft Corp., U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6877 (W.D. Wash. 2015)   | Summons enforced; IRS's hiring of law firm to assist with exam of TP was not improper  | No     | IRS      |
| <i>Neuberger v. U.S.</i> , 2016 U.S. Dist. LEXIS 59371 (W.D. Pa. 2016)  | Summons enforced; TP's motion to quash third-party summons denied  | No     | IRS      |
| <i>Newton, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1488 (E.D. Ky. 2016), <i>adopting</i> 117 A.F.T.R.2d (RIA) 1486 (E.D. Ky. 2016)   | Summons enforced   | Yes    | IRS      |
| <i>Regency Int'l v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1033 (D. Md. 2016)  | Summons enforced; TP's petition to quash denied  | No     | IRS      |
| <i>Schaeffler v. U.S.</i> , 806 F.3d 34 (2d Cir. 2015), <i>vacating and remanding</i> 22 F. Supp. 3d 319 (S.D.N.Y. 2014), <i>dismissed as moot</i> , 117 A.F.T.R.2d (RIA) 2139 (S.D.N.Y. 2016)  | Summons denied; TPs entitled to attorney-client and work-product privileges  | No     | TP       |

TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

| Case Citation  | Issue(s)  | Pro Se | Decision |
|--|---|--------|----------|
| <i>Solid Waste Servs., Inc. v. U.S.</i> , 2016 U.S. Dist. LEXIS 20151 (E.D. Pa. 2016), <i>adopting</i> 2016 U.S. Dist. LEXIS 21493 (E.D. Pa. 2016) | Summons enforced; TP's petition to quash third-party summons denied | No     | IRS      |
| <i>Titan Itern., Inc., U.S. v.</i> , 811 F.3d 950 (7th Cir. 2016), <i>aff'g</i> 114 A.F.T.R.2d (RIA) 6934 (C.D. Ill. 2014)                         | Summons enforced  | No     | IRS      |

**TABLE 4 Gross Income Under IRC § 61 and Related Sections**

| Case Citation  | Issue(s)   | Pro Se | Decision |
|--|--|--------|----------|
| Individual Taxpayers (But not Sole Proprietorships)  |  |        |          |
| <i>Adams v. Comm'r</i> , T.C. Memo. 2015-162, appeal dismissed, No. 16-1043 (4th Cir. May 20, 2016)                        | Unreported retirement income   | Yes    | IRS      |
| <i>Agudelo v. Comm'r</i> , T.C. Memo. 2015-124   | Unreported unemployment compensation   | Yes    | IRS      |
| <i>Barbato v. Comm'r</i> , T.C. Memo. 2016-23  | Unreported award for emotional distress  | Yes    | IRS      |
| <i>Bhutta v. Comm'r</i> , 145 T.C. 351 (2015)  | Income not exempt by treaty  | No     | IRS      |
| <i>Campbell v. U.S.</i> , 607 F. App'x 697 (9th Cir. 2015), <i>aff'g</i> 111 A.F.T.R.2d (RIA) 946 (C.D. Cal. 2013)         | Unreported disability retirement income  | No     | IRS      |
| <i>Chambers v. Comm'r</i> , T.C. Memo. 2016-72   | Unreported retirement income   | Yes    | IRS      |
| <i>Clark v. Comm'r</i> , T.C. Memo. 2015-175   | Unreported cancellation of debt income   | No     | TP       |
| <i>Co v. Comm'r</i> , T.C. Memo. 2016-19   | Unreported foreign earned income   | No     | IRS      |
| <i>Cole v. Comm'r</i> , T.C. Summ. Op. 2016-22   | Unreported foreign earned income; Income not exempt by treaty  | Yes    | IRS      |
| <i>Crabtree v. Comm'r</i> , T.C. Memo. 2015-163  | Unreported support payments received from divorce decree were not alimony income                                 | No     | TP       |
| <i>Curtis v. Comm'r</i> , 117 A.F.T.R.2d (RIA) 1347 (9th Cir. 2016), <i>aff'g</i> T.C. Memo. 2013-12                       | Unreported rental income and capital gains   | Yes    | IRS      |
| <i>Dinger v. Comm'r</i> , T.C. Memo. 2015-145  | Unreported foreign earned income   | Yes    | IRS      |
| <i>Dulanto v. Comm'r</i> , T.C. Memo. 2016-34, appeal docketed, No. 16-72867 (9th Cir. Aug. 29, 2016)                      | Settlement proceeds were taxable and did not fall under IRC § 104(a)(2) exception                                | Yes    | IRS      |
| <i>Dunnigan v. Comm'r</i> , T.C. Memo. 2015-190  | Unreported cancellation of debt income   | Yes    | IRS      |
| <i>Friedman v. Comm'r</i> , T.C. Memo. 2015-177  | Unreported interest income   | No     | IRS      |
| <i>Gillespie v. U.S.</i> , 117 A.F.T.R.2d (RIA) 641 (E.D. Wis. 2016), appeal docketed, No. 16-1465 (7th Cir. Mar. 2, 2016) | Unreported wage income   | Yes    | IRS      |
| <i>Green v. Comm'r</i> , T.C. Memo. 2016-67  | Unreported wage income   | Yes    | IRS      |
| <i>Ireland v. Comm'r</i> , T.C. Summ. Op. 2015-60  | Unreported retirement income   | Yes    | IRS      |
| <i>Jijun Chen v. Comm'r</i> , T.C. Memo. 2015-167  | Unreported state tax refund  | Yes    | IRS      |
| <i>Kakeh v. Comm'r</i> , T.C. Memo. 2015-103   | Unreported settlement proceeds   | No     | IRS      |
| <i>Martin v. Comm'r</i> , T.C. Memo. 2016-15   | Unreported gambling winnings   | Yes    | IRS      |
| <i>McDougall v. Comm'r</i> , T.C. Summ. Op. 2015-65  | Unreported wage income   | Yes    | IRS      |
| <i>McGaugh v. Comm'r</i> , T.C. Memo. 2016-28, appeal docketed, No. 16-2987 (7th Cir. July 21, 2016)                       | Unreported retirement income   | No     | TP       |
| <i>Nitschke v. Comm'r</i> , T.C. Memo. 2016-78   | Unreported nonemployee compensation and cancellation of debt income  | Yes    | IRS      |
| <i>Nuzum v. Comm'r</i> , T.C. Summ. Op. 2016-9   | Unreported alimony   | No     | IRS      |
| <i>O'Connor v. Comm'r</i> , 606 F. App'x 390 (9th Cir. 2015), <i>aff'g</i> T.C. Memo. 2012-317                             | Compensation from participation in medical research study not excludible from gross income under IRC § 104(a)(2) | Yes    | IRS      |
| <i>O'Connor v. Comm'r</i> , T.C. Memo. 2015-244  | Unreported income from transfer of ownership of cash value life insurance policy                                 | No     | IRS      |
| <i>O'Neal v. Comm'r</i> , T.C. Memo. 2016-49   | Unreported income  | Yes    | IRS      |

TABLE 4: Gross Income Under IRC § 61 and Related Sections

| Case Citation  | Issue(s)   | Pro Se | Decision |
|--|--|--------|----------|
| <i>Putnam v. Comm’r</i> , T.C. Memo. 2015-160  | Unreported income  | Yes    | IRS      |
| <i>Read v. Comm’r</i> , T.C. Memo. 2015-115  | Unreported capital gains and dividend income   | Yes    | IRS      |
| <i>Rivera v. Comm’r</i> , T.C. Memo. 2016-35   | Unreported state tax refund  | Yes    | IRS      |
| <i>Rodriguez v. Comm’r</i> , T.C. Memo. 2015-178   | Unreported retirement income   | Yes    | IRS      |
| <i>Sana v. Comm’r</i> , T.C. Summ. Op. 2015-72   | Unreported retirement income; Military retirement pay was taxable  | Yes    | IRS      |
| <i>Shakir v. Comm’r</i> , T.C. Memo. 2015-147  | Unreported wage, retirement, and Social Security income  | Yes    | IRS      |
| <i>Shimaneck v. Comm’r</i> , T.C. Memo. 2015-165   | Unreported wage income   | Yes    | IRS      |
| <i>Simmons v. Comm’r</i> , T.C. Memo. 2015-252   | Unreported capital gains income  | Yes    | IRS      |
| <i>Smallwood v. U.S.</i> , 608 F. App’x 490 (9th Cir. 2015), <i>vacating and remanding</i> 111 A.F.T.R.2d (RIA) 377 (C.D. Cal. 2012) | Settlement proceeds under IRC § 104(a)(2)  | No     | TP       |
| <i>Smith v. U.S.</i> , 168 F. Supp. 3d 1221 (D. Ariz. 2016), <i>appeal docketed</i> , No. 16-15820 (9th Cir. May 4, 2016)            | Unreported wage and retirement income  | Yes    | IRS      |
| <i>Stanley v. Comm’r</i> , 608 F. App’x 434 (8th Cir. 2015)  | Unreported wage income   | Yes    | IRS      |
| <i>Stout v. Comm’r</i> , T.C. Memo. 2015-133, <i>appeal docketed</i> , No. 16-1212 (6th Cir. Feb. 19, 2016)                          | Unreported compensation income   | Yes    | IRS      |
| <i>Striker v. Comm’r</i> , T.C. Memo. 2015-248   | Unreported foreign earned income   | No     | IRS      |
| <i>Taylor v. Comm’r</i> , T.C. Summ. Op. 2015-51   | Unreported retirement income; Military retirement pay was taxable  | Yes    | IRS      |
| <i>Thiessen v. Comm’r</i> , 146 T.C. 100 (2016)  | Unreported retirement income   | Yes    | IRS      |
| <i>Thompson v. Comm’r</i> , T.C. Summ. Op. 2016-20   | Unreported Social Security income  | Yes    | IRS      |
| <i>Tobias v. Comm’r</i> , T.C. Memo. 2015-164  | Unreported income from withdrawal of variable annuity contract   | Yes    | IRS      |
| <i>Trainito v. Comm’r</i> , T.C. Summ. Op. 2015-37   | Unreported cancellation of debt income   | No     | IRS      |
| <i>Vandenbosch v. Comm’r</i> , T.C. Memo. 2016-29  | Unreported retirement income   | No     | IRS      |
| <i>Webber v. Comm’r</i> , 144 T.C. 324 (2015)  | Unreported income from variable life insurance policies  | No     | IRS      |
| <i>Wilson v. Comm’r</i> , T.C. Summ. Op. 2016-19   | Unreported foreign earned income partially taxable   | Yes    | Split    |
| <b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedules C, E, F)</b>                         |  |        |          |
| <i>Alhadi v. Comm’r</i> , T.C. Memo. 2016-74   | Unreported nonemployee compensation; Evidence of undue influence on elderly client disproved TP’s characterization of gift or loan | Yes    | IRS      |
| <i>Bell v. Comm’r</i> , T.C. Memo. 2015-111, <i>appeal docketed</i> , No. 16-70166 (9th Cir. Jan. 19, 2016)                          | Unreported dividend income   | No     | IRS      |
| <i>Blagaich v. Comm’r</i> , T.C. Memo. 2016-2  | Unreported nonemployee compensation; Money did not qualify as gift   | No     | IRS      |
| <i>Bosque Canyon Ranch, L.P. v. Comm’r</i> , T.C. Memo. 2015-130, <i>appeal docketed</i> , No. 16-60068 (5th Cir. Jan. 28, 2016)     | Unreported income from the sale of property to partnership   | No     | IRS      |
| <i>Bruhwyler v. Comm’r</i> , T.C. Memo. 2016-18  | Unreported nonemployee compensation and interest   | Yes    | IRS      |
| <i>Foryan v. Comm’r</i> , T.C. Memo. 2015-114  | Unreported nonemployee compensation  | Yes    | IRS      |
| <i>Garada v. Comm’r</i> , T.C. Summ. Op. 2016-1  | Unreported income and interest   | Yes    | IRS      |

TABLE 4: Gross Income Under IRC § 61 and Related Sections

| Case Citation   | Issue(s)   | Pro Se | Decision |
|---|--|--------|----------|
| <i>George v. Comm'r</i> , T.C. Memo. 2015-158, <i>aff'd</i> by 2016 U.S. App. LEXIS 16733 (1st Cir. 2016)                                     | Unreported nonemployee income was not exempt from taxation under IRC § 501(a)  | No     | IRS      |
| <i>Greene v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1411 (D. Ariz. 2016)   | Unreported nonemployee compensation  | Yes    | IRS      |
| <i>Herrmann v. U.S.</i> , 124 Fed. Cl. 56 (2015)  | Unreported partnership distribution  | No     | Split    |
| <i>Holden v. Comm'r</i> , T.C. Memo. 2015-131   | Unreported business income   | No     | IRS      |
| <i>Hussein v. Comm'r</i> , T.C. Summ. Op. 2015-59   | Unreported nonemployee compensation  | Yes    | IRS      |
| <i>Kavuma v. Comm'r</i> , T.C. Memo. 2016-101   | Unreported nonemployee compensation  | Yes    | IRS      |
| <i>Key Carpets, Inc. v. Comm'r</i> , T.C. Memo. 2016-30   | Unreported dividend income   | No     | IRS      |
| <i>Laudon v. Comm'r</i> , T.C. Summ. Op. 2015-54  | Unreported nonemployee compensation  | Yes    | IRS      |
| <i>Lawson v. Comm'r</i> , T.C. Memo. 2015-211   | Unreported settlement proceeds and unreported Schedule C and Schedule E income | Yes    | IRS      |
| <i>Machacek v. Comm'r</i> , T.C. Memo. 2016-55  | Unreported nonqualified deferred compensation and split-dollar life insurance  | No     | IRS      |
| <i>Makric Enters., Inc. v. Comm'r</i> , T.C. Memo. 2016-44, <i>appeal docketed</i> , No. 16-60410 (5th Cir. June 17, 2016)                    | Unreported capital gains   | No     | IRS      |
| <i>Non Profit Ins. v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1427 (E.D. Wash. 2016), <i>appeal dismissed</i> , No. 16-35379 (9th Cir. June 27, 2016) | Income not exempt from federal tax under IRC § 115(1)                          | No     | IRS      |
| <i>Ocampo v. Comm'r</i> , T.C. Memo. 2015-150   | Unreported business income and other income                                    | Yes    | Split    |
| <i>Omar v. Comm'r</i> , T.C. Memo. 2015-238   | Unreported business income   | No     | IRS      |
| <i>Our Country Home Enters., Inc. v. Comm'r</i> , 145 T.C. 1 (2015)   | Unreported split-dollar life insurance and dividend income                     | No     | IRS      |
| <i>Polowniak v. Comm'r</i> , T.C. Memo. 2016-31, <i>appeal docketed</i> , No. 16-2355 (6th Cir. Sept. 29, 2016)                               | Unreported business income   | No     | IRS      |
| <i>Porter v. Comm'r</i> , T.C. Memo. 2015-122   | Unreported business income   | Yes    | IRS      |
| <i>Rey v. Comm'r</i> , T.C. Memo. 2016-58   | Unreported nonemployee compensation  | Yes    | IRS      |
| <i>Route 231, LLC v. Comm'r</i> , 810 F.3d 247 (4th Cir. 2016), <i>aff'g</i> T.C. Memo. 2014-30   | Unreported income from sale of property  | No     | IRS      |
| <i>Schank v. Comm'r</i> , T.C. Memo. 2015-235   | Unreported dividend income   | No     | IRS      |
| <i>Starke v. Comm'r</i> , T.C. Summ. Op. 2015-40  | Unreported nonemployee compensation  | Yes    | TP       |
| <i>Stough v. Comm'r</i> , 144 T.C. 306 (2015)   | Unreported rental income   | No     | IRS      |
| <i>Summa Holdings, Inc. v. Comm'r</i> , T.C. Memo. 2015-119, <i>appeal docketed</i> , No. 16-1712 (6th Cir. June 1, 2016)                     | Unreported dividend income   | No     | IRS      |
| <i>Wagner v. Comm'r</i> , T.C. Memo. 2015-120   | Unreported business and rental income  | Yes    | IRS      |
| <i>Whittington v. Comm'r</i> , T.C. Memo. 2015-152, <i>appeal docketed</i> , No. 16-70199 (9th Cir. Jan. 21, 2016)                            | Unreported reimbursement of travel expenses were taxable                       | Yes    | IRS      |



**TABLE 5 Trade or Business Expenses Under IRC § 162 and Related Sections**

| Case Citation  | Issue(s)   | Pro se | Decision |
|--|--|--------|----------|
| <b>Individual Taxpayers (But Not Sole Proprietorships)</b>   |  |        |          |
| <i>Akey v. Comm’r</i> , T.C. Memo. 2015-227  | Failure to establish overall activity as a qualifying trade or business within §162(a); Not engaged in for profit under §183   | Yes    | IRS      |
| <i>Aleamoni v. Comm’r</i> , T.C. Summ. Op. 2016-21   | Not entitled to deduct on individual return advances made to C corporation under §162(a)   | Yes    | IRS      |
| <i>Amegankpoe v. Comm’r</i> , T.C. Summ. Op. 2015-36   | Failure to meet §274 substantiation requirements for vehicle and travel expenses; Cellular phone and internet were personal expenses   | Yes    | IRS      |
| <i>Avery v. Comm’r</i> , T.C. Memo. 2016-50  | Failure to meet §274 substantiation requirements for vehicle and travel expenses; Improper filing of Schedule C  | Yes    | IRS      |
| <i>Beltifa v. Comm’r</i> , T.C. Summ. Op. 2016-8   | Failure to substantiate unreimbursed employee business expenses  | Yes    | IRS      |
| <i>Britto-Bernstein v. Comm’r</i> , T.C. Summ. Op. 2016-3  | Failure to substantiate unreimbursed employee business expenses  | Yes    | IRS      |
| <i>Chaudry v. Comm’r</i> , T.C. Summ. Op. 2015-74  | Failure to substantiate unreimbursed employee business expenses  | Yes    | IRS      |
| <i>Garcia v. Comm’r</i> , T.C. Memo. 2016-21   | Failure to meet §274 substantiation requirements for travel and meals; Failure to substantiate unreimbursed employee business expenses; Cellular phone expense was personal  | Yes    | IRS      |
| <i>Hom v. Comm’r</i> , 117 A.F.T.R.2d (RIA) 1120 (9th Cir. 2016), <i>aff’g</i> T.C. Memo. 2013-163           | Failure to substantiate gambling expenses  | Yes    | IRS      |
| <i>Santos v. Comm’r</i> , T.C. Memo. 2016-100  | Law school tuition not deductible because it qualified TP for a new trade or business  | Yes    | IRS      |
| <b>Business Taxpayers (Corporate, Partnerships, Trusts, and Sole Proprietorships- Schedules C, E, F)</b>     |  |        |          |
| <i>Agro-Jal Farming Enters., Inc. v. Comm’r</i> , 145 T.C. 145 (2015)  | TP may deduct the cost of field-packing materials for the year of purchase   | No     | TP       |
| <i>Arizaga v. Comm’r</i> , T.C. Memo. 2016-57  | Failure to substantiate supplies and contract labor expenses; Cohan rule applied to allow deductions for cost of goods, wages, and advertising   | Yes    | Split    |
| <i>Batchelor-Robjohns v. U.S.</i> , 788 F.3d 1280 (11th Cir. 2015)   | Estate barred from claiming an income tax deduction of a capital loss for the same payments because they arose from a transaction resulting in capital gain and thus were not ordinary and necessary business expenses | No     | IRS      |
| <i>Beaubrun v. Comm’r</i> , T.C. Memo. 2015-217  | Failure to substantiate vehicle, cellular phone, and other business expenses; Failure to meet §274 substantiation requirements   | No     | IRS      |
| <i>Beck v. Comm’r</i> , T.C. Memo. 2015-149  | Medical marijuana dispensary activity prohibited under §280E from deducting cost of goods sold and other expenses since business consists of the trafficking of a controlled substance                                 | Yes    | IRS      |
| <i>Besaw v. Comm’r</i> , T.C. Memo. 2015-233, <i>appeal docketed</i> , No. 16-70264 (9th Cir. Jan. 28, 2016) | Failure to meet §274 substantiation requirements for travel and meals; Failure to substantiate other expenses, transfers to family were not compensation for services  | Yes    | IRS      |
| <i>Boneparte v. Comm’r</i> , T.C. Memo. 2015-128   | Failure to establish gambling activity as a qualifying trade or business under §162(a); Not engaged in for profit under §183   | Yes    | IRS      |

TABLE 5: Trade or Business Expenses Under IRC § 162 and Related Sections

| Case Citation   | Issue(s)  | Pro se | Decision |
|---|---|--------|----------|
| <i>Boring v. Comm'r</i> , T.C. Summ. Op. 2015-68  | Failure to substantiate Schedule C expenses; Home office deduction disallowed under §280A; Home repair and architect fees were personal   | Yes    | IRS      |
| <i>Callender v. Comm'r</i> , T.C. Memo. 2016-68   | Failure to substantiate expenses from TP's own legal practice and failed to include a Schedule C; Failure to prove the expenditures were ordinary and necessary business expenses; Failure to meet §274 expenses  | Yes    | IRS      |
| <i>Canna Care, Inc. v. Comm'r</i> , T.C. Memo. 2015-206, appeal docketed, No. 16-70265 (9th Cir. Jan. 28, 2016) | Medical marijuana dispensary activity prohibited under §280E from deducting operating expenses since business consists of the trafficking of a controlled substance   | No     | IRS      |
| <i>Cartwright v. Comm'r</i> , T.C. Memo. 2015-212   | §179 depreciation disallowed  | No     | IRS      |
| <i>Charley v. Comm'r</i> , T.C. Memo. 2015-232  | Vehicle and mileage expenses met under §274 because TP substantiated expenses with specific and detailed oral testimony and other corroborative evidence  | Yes    | TP       |
| <i>Delia v. Comm'r</i> , T.C. Memo. 2016-71   | Salon was an activity engaged in for profit under §183; Partial allowance of supplies and hair product expenses; Failure to substantiate cellular phone and meal expenses   | Yes    | Split    |
| <i>Espallat v. Comm'r</i> , T.C. Memo. 2015-202   | Failure to establish overall activity as a qualifying trade or business under §162(a); Schedule C losses disallowed because no such business existed  | No     | IRS      |
| <i>Ezzell v. Comm'r</i> , T.C. Summ. Op. 2015-52  | Some repairs, maintenance and other expenses allowed as ordinary and necessary; Partial allowance for some utilities, cellular phone and mileage expenses while remainder disallowed as personal use  | Yes    | Split    |
| <i>Fisher v. Comm'r</i> , T.C. Summ. Op. 2016-10  | Cohan rule applied to allow some wages paid from TP's law practice to TP's minor children for rudimentary office help; Failure to establish book writing activity as a qualifying trade or business under §162(a)   | Yes    | Split    |
| <i>Garada v. Comm'r</i> , T.C. Summ. Op. 2016-1   | Failure to meet §274 substantiation requirements for travel expenses  | Yes    | IRS      |
| <i>Grossnickle v. Comm'r</i> , T.C. Memo. 2015-127  | Failure to substantiate cellular phone and internet expenses; Failure to meet the §274 substantiation requirements for vehicle expenses; Portion of real estate license fees and realtor association dues were allowed; Home office disallowed  | Yes    | Split    |
| <i>Hastings v. Comm'r</i> , T.C. Memo. 2016-61  | Failure to meet §274 substantiation requirements for vehicle expenses; Partial allowance for meals, lodging and entertainment expenses while remainder was disallowed as personal expense; Moving expense reclassified by court as employee business expense and allowed as a deduction; Partial allowance for substantiated unreimbursed business expenses and home office expense | Yes    | Split    |
| <i>Hawk v. Comm'r</i> , T.C. Memo. 2015-139   | Home offices disallowed; Failure to meet §274 substantiation requirements for use of vehicle and for gift expenses; Business standard mileage rate disallowed on a vehicle used but not owned by TP; Personal expenses disallowed   | Yes    | IRS      |
| <i>Henao v. Comm'r</i> , T.C. Summ. Op. 2016-7  | Office rental disallowed due to lack of substantiation; Partial allowance for meals and gifts as ordinary and necessary expenses; Failure to meet the §274 substantiation requirements for other meals, entertainment, and gifts; Shipping and travel expenses allowed  | No     | Split    |
| <i>Herrera v. Comm'r</i> , T.C. Memo. 2015-251  | Collateral estoppel applies to carryover of prior disallowed business bad debt  | No     | IRS      |

TABLE 5: Trade or Business Expenses Under IRC § 162 and Related Sections

| Case Citation  | Issue(s)   | Pro se | Decision |
|--|--|--------|----------|
| <i>Hoffman v. Comm'r</i> , T.C. Summ. Op. 2015-73        | Failure to substantiate Schedule C expenses  | Yes    | IRS      |
| <i>Hoffmann v. Comm'r</i> , T.C. Memo. 2016-69           | Executive jet service activity was not engaged in for profit under §183  | No     | IRS      |
| <i>Holden v. Comm'r</i> , T.C. Memo. 2015-131            | Salaries and wages paid were partially allowed despite failure to file respective tax forms; Equipment rental was ordinary and necessary business expense; Some interest payments and other expenses substantiated; Failure to meet §274 substantiation requirements for vehicle expense   | No     | Split    |
| <i>H.W. Johnson, Inc. v. Comm'r</i> , T.C. Memo. 2016-95 | Officer compensation payment reasonable and ordinary and necessary business expense  | No     | TP       |
| <i>Isaacs v. Comm'r</i> , T.C. Memo. 2015-121            | Failure to substantiate expenses due to stolen records; Cohan rule applied and some allowances for lab fees, office overhead expenses, supplies, professional fees and ancillary expenses  | Yes    | Split    |
| <i>Jackson v. Comm'r</i> , T.C. Summ. Op. 2016-11        | Failure to substantiate expenses for building materials, tools or supplies; Failure to meet §274 substantiation requirements for vehicle expense; Portion of cellular phone expenses allowed; Unable to use Cohan rule   | Yes    | Split    |
| <i>Jijun Chen v. Comm'r</i> , T.C. Memo. 2015-167        | Failure to meet §274 substantiation requirements for vehicle expense; Travel, entertainment, depreciation and other expenses were personal and not ordinary and necessary business expenses; Home office expenses disallowed   | Yes    | IRS      |
| <i>Judah v. Comm'r</i> , T.C. Memo. 2015-243             | Saddlebreds horse activity was not engaged in for profit under §183; Saddlebred horse activity and real estate two distinct activities   | No     | IRS      |
| <i>Kaiser v. Comm'r</i> , T.C. Summ. Op. 2016-13         | Horse training activity was not engaged in for profit under §183   | No     | IRS      |
| <i>Kantchev v. Comm'r</i> , T.C. Memo. 2015-234          | Photography activity was not engaged in for profit under §183  | No     | IRS      |
| <i>Key Carpets, Inc. v. Comm'r</i> , T.C. Memo. 2016-30  | Payments to develop technology of a voice-activated hand washing monitoring system were not an ordinary and necessary expense because TP did not own the technology patent or benefit from the payments for the development of the system; Partial deduction for computer technician salary expense allowed using the Cohan rule | No     | Split    |
| <i>Kline v. Comm'r</i> , T.C. Memo. 2015-144             | Substantiated franchise fees, supplies and other expenses; Met §274 substantiation requirements for additional travel expenses   | No     | TP       |
| <i>Laudon v. Comm'r</i> , T.C. Summ. Op. 2015-54         | Failure to meet §274 substantiation requirements for vehicle usage; Home office disallowed   | Yes    | IRS      |
| <i>Machacek v. Comm'r</i> , T.C. Memo. 2016-55           | May not deduct contributions to a purported welfare benefit plan because it was not an ordinary and necessary expense  | No     | IRS      |
| <i>McMillan v. Comm'r</i> , T.C. Memo. 2015-109          | Equine activity not engaged in for profit under §183; Portion of legal expenses allowed as ordinary and necessary expenses in connection to the IT business; Interest deduction substantiated  | Yes    | Split    |
| <i>Newhouse v. Comm'r</i> , T.C. Summ. Op. 2015-71       | Cohan rule applied to allow postage expenses; Failure to substantiate net operating loss (NOL) carryforward  | Yes    | Split    |
| <i>Niemann v. Comm'r</i> , T.C. Memo. 2016-11            | Failure to meet §274 substantiation requirements for travel, meals, and entertainment; Failure to establish loan making activity as a qualifying trade or business under §162(a)   | Yes    | IRS      |

TABLE 5: Trade or Business Expenses Under IRC § 162 and Related Sections

| Case Citation  | Issue(s)   | Pro se | Decision |
|--|--|--------|----------|
| <i>Nkonoki v. Comm'r</i> , T.C. Memo. 2016-93  | Moving and storage expenses substantiated by testimony; Failure to meet §274 substantiation requirements for travel, vehicle, phone and gift expenses  | Yes    | Split    |
| <i>Ocampo v. Comm'r</i> , T.C. Memo. 2015-150  | Failure to meet §274 substantiation requirements for additional vehicle expenses; Failure to substantiate business interest expense; Depreciation on vehicles allowed  | Yes    | Split    |
| <i>Our Country Home Enters., Inc. v. Comm'r</i> , 145 T.C. 1 (2015)  | Split-dollar life insurance plan premiums were not ordinary and necessary expenses and no life insurance policy was transferred to participating employees during the relevant years                                     | No     | IRS      |
| <i>Philbrick v. Comm'r</i> , T.C. Memo. 2016-64  | Failure to substantiate Schedule C expenses  | Yes    | IRS      |
| <i>Pingel v. Comm'r</i> , T.C. Summ. Op. 2015-48   | Travel guide writer activity was not engaged in for profit under §183  | Yes    | IRS      |
| <i>Polowniak v. Comm'r</i> , T.C. Memo. 2016-31, appeal docketed, Nos. 16-2355 & 16-2357 (6th Cir. Sept. 29, 2016)   | Deduction allowed to the extent substantiation was provided; Failure to meet §274 substantiation requirements for travel, meals and entertainment expenses   | No     | IRS      |
| <i>Porter v. Comm'r</i> , T.C. Memo. 2015-122  | Failure to substantiate loan and computer expenses; Some allowance of cash wages paid to laborers; Failure to meet §274 substantiation requirements for vehicle expense  | Yes    | Split    |
| <i>Pouemi v. Comm'r</i> , T.C. Memo. 2015-161, <i>aff'd</i> by 633 F. App'x 186 (4th Cir. 2016)  | Real estate activity was not engaged in for profit under §183  | Yes    | IRS      |
| <i>Price v. Comm'r</i> , 633 F. App'x 101 (3d Cir. 2016)   | Horse farm activity was not engaged in for profit under §183; Horse farm activity and auto dealership two distinct activities  | No     | IRS      |
| <i>Reinhard v. Comm'r</i> , T.C. Memo. 2015-116  | Failure to substantiate NOL deduction  | Yes    | IRS      |
| <i>Renner v. Comm'r</i> , T.C. Memo. 2015-102, <i>aff'd</i> by docket No. 15-1711 (6th Cir. Jan. 20, 2016), <i>cert. denied</i> by docket No. 15-9239 (June 6, 2016) | Failure to meet §274 substantiation requirements for vehicle expenses  | Yes    | IRS      |
| <i>Roberts v. Comm'r</i> , 820 F.3d 247 (7th Cir. Apr. 15, 2016), <i>rev'g</i> T.C. Memo. 2014-74  | Horse racing activity was a qualifying trade or business within §162(a)  | No     | TP       |
| <i>Schank v. Comm'r</i> , T.C. Memo. 2015-235  | Constructive dividends are not an allowable expense  | No     | IRS      |
| <i>Smith v. Comm'r</i> , T.C. Memo. 2015-214   | Travel expenses disallowed because employment was indefinite and location was TP's tax home; Failure to substantiate meals, entertainment, credit card interest and costs of goods sold expenses; Home office disallowed | Yes    | IRS      |
| <i>Sodipo v. Comm'r</i> , 117 A.F.T.R.2d (RIA) 738 (4th Cir. 2016), <i>aff'g</i> T.C. Memo. 2015-3   | Failure to substantiate Schedule C-2 expenses  | Yes    | IRS      |
| <i>Spjute v. Comm'r</i> , T.C. Summ. Op. 2015-58   | Home office disallowed; Failure to meet §274 substantiation requirements for mileage; Additional business expenses substantiated for legal and professional services   | No     | Split    |
| <i>Strode v. Comm'r</i> , 116 A.F.T.R.2d (RIA) 6568 (9th Cir. 2015), <i>aff'g</i> T.C. Memo. 2015-117  | International consulting activity was not engaged in for profit under §183   | No     | IRS      |
| <i>Stuller, Estate of, v. U.S.</i> , 811 F.3d 890 (7th Cir. 2016)  | Horse-breeding operation was not engaged in for profit under §183  | No     | IRS      |
| <i>Wan-Wen Lau v. Comm'r</i> , T.C. Memo. 2015-137   | Failure to substantiate depreciation expense; Failure to meet §274 substantiation requirements for meal and entertainment expenses; Home office disallowed   | Yes    | IRS      |
| <i>Wideman v. Comm'r</i> , T.C. Summ. Op. 2015-61  | Phone expense disallowed as personal expense; Failure to substantiate miscellaneous expenses   | Yes    | IRS      |

TABLE 5: Trade or Business Expenses Under IRC § 162 and Related Sections

| Case Citation  | Issue(s)   | Pro se | Decision |
|--|--|--------|----------|
| <i>Wiley M. Elick DDS, Inc. v. Comm’r</i> , 117 A.F.T.R.2d (RIA) 457 (9th Cir. 2016), <i>aff’g</i> T.C. Memo. 2013-139, <i>cert. denied</i> , 136 S. Ct. 2043 (2016) | Management company fees were not ordinary and necessary because no service was provided  | No     | IRS      |
| <i>WSK &amp; Sons, Inc. v. Comm’r</i> , T.C. Memo. 2015-204, <i>appeal docketed</i> , No. 16-70772 (9th Cir. Mar. 22, 2016)  | Failure to substantiate advertising and depreciation expenses  | No     | IRS      |
| <i>Young v. Comm’r</i> , T.C. Memo. 2015-189, <i>appeal dismissed</i> , No. 16-1486 (6th Cir. July 15, 2016)   | Failure to substantiate Schedule C expenses; Flood and computer crash explanations were not credible; Portion of home office allowed | Yes    | Split    |
| <i>Zavadil v. Comm’r</i> , 793 F.3d 866 (8th Cir. 2015), <i>aff’g</i> T.C. Memo. 2013-22   | Payments to former colleague’s widow and outside consulting business were not ordinary and necessary business expenses               | No     | IRS      |

**TABLE 6 Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654**

| Case Citation   | Issue(s)   | Pro Se | Decision |
|---|--|--------|----------|
| <b>Individual Taxpayers (But Not Sole Proprietorships)</b>  |  |        |          |
| <i>Balice v. Comm'r</i> , 634 F. App'x 349 (3d Cir. 2016), <i>cert denied</i> , No. 15-9781 (Oct. 3, 2016)    | 6651(a)(1),(2) – No reasonable cause   | Yes    | IRS      |
| <i>Bell v. Comm'r</i> , T.C. Memo. 2015-101   | 6651(a)(1),(2) – No reasonable cause   | Yes    | IRS      |
| <i>Bruhwyler v. Comm'r</i> , T.C. Memo. 2016-18   | 6651(a)(1),(2) – No reasonable cause   | Yes    | IRS      |
| <i>Carter v. U.S. v.</i> , 117 A.F.T.R.2d (RIA) 304 (E.D. Va. 2016)   | 6651 (a)(1),(2), 6654 – Summary judgment, no genuine issue of material fact  | Yes    | IRS      |
| <i>Chambers v. Comm'r</i> , T.C. Memo. 2016-72  | 6651(a)(1),(2) – No reasonable cause   | Yes    | IRS      |
| <i>Crummey v. Comm'r</i> , T.C. Memo. 2016-9  | 6651(a)(2) – No reasonable cause   | Yes    | IRS      |
| <i>Evans v. Comm'r</i> , T.C. Memo. 2016-7  | 6651(a)(1) – Emotional distress did not establish reasonable cause<br>6651(a)(2) – Taxpayer did not establish that he was unable to pay the tax or that paying would cause an undue hardship<br>6654 – IRS did not meet its burden of production | No     | Split    |
| <i>Foryan v. Comm'r</i> , T.C. Memo. 2015-114   | 6651(a)(1),(2) – No reasonable cause<br>6654 – No exception  | Yes    | IRS      |
| <i>Green v. Comm'r</i> , T.C. Memo. 2016-67   | 6651(a)(2) – No reasonable cause<br>6654 – IRS did not meet its burden of production   | Yes    | Split    |
| <i>Hill v. Comm'r</i> , T.C. Memo. 2015-172   | 6651(a)(1) – No reasonable cause   | No     | IRS      |
| <i>Ibarra v. Comm'r</i> , T.C. Summ. Op. 2015-70  | 6651(a)(1),(2) – Undue hardship created by spouse's illness established reasonable cause<br>6654 – No exceptions applied   | Yes    | Split    |
| <i>Kantchev v. Comm'r</i> , T.C. Memo. 2015-234   | 6651(a)(1) – No reasonable cause   | Yes    | IRS      |
| <i>Lau v. Comm'r</i> , T.C. Memo. 2015-137  | 6651(a)(1),(2) – Taxpayer offered no reasonable cause argument<br>6654 – No exceptions apply   | Yes    | IRS      |
| <i>McDougall v. Comm'r</i> , T.C. Summ. Op. 2015-65   | 6651(a)(1),(2) – Incarceration does not establish reasonable cause   | Yes    | IRS      |
| <i>Miller v. Comm'r</i> , T.C. Memo. 2016-73  | 6651(a)(2) – Taxpayer failed to show ordinary business care and prudence; Reliance on tax professional did not establish reasonable cause  | No     | IRS      |
| <i>Morris v. Comm'r</i> , T.C. Memo. 2016-16  | 6651(a)(2) – Taxpayer failed to show ordinary business care and prudence   | Yes    | IRS      |
| <i>Nitschke v. Comm'r</i> , T.C. Memo. 2016-078   | 6651(a)(1),(2) – No reasonable cause<br>6654 – No exceptions applied   | Yes    | IRS      |
| <i>O'Neal v. Comm'r</i> , T.C. Memo. 2016-49  | 6651(a)(1) – Taxpayer offered no reasonable cause argument   | Yes    | IRS      |
| <i>Poppe v. Comm'r</i> , T.C. Memo. 2015-205  | 6651(a)(1),(2) – Mental condition did not establish reasonable cause<br>6654 – No exceptions applied   | No     | IRS      |
| <i>Putnam v. Comm'r</i> , T.C. Memo. 2015-160   | 6651(a)(2) – IRS met its burden of production<br>6654 – No exceptions apply  | Yes    | IRS      |
| <i>Redstone v. Comm'r</i> , T.C. Memo. 2015-237   | 6651(a)(1) – Reliance on tax professionals established reasonable cause  | No     | TP       |
| <i>Reifler v. Comm'r</i> , T.C. Memo. 2015-199, <i>appeal dismissed</i> , No. 16-1172 (2d Cir. July 20, 2016) | 6651(a)(1) – Taxpayer failed to show ordinary business care and prudence   | No     | IRS      |



TABLE 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

| Case Citation   | Issue(s)  | Pro Se | Decision |
|---|---|--------|----------|
| <i>Selbst, In re</i> , v. U.S., 544 B.R. 289 (E.D. N.Y. 2016)   | 6651(a)(1) – No reasonable cause  | No     | IRS      |
| <i>Shakir v. Comm’r</i> , T.C. Memo. 2015-147   | 6651(a)(1),(2) – No reasonable cause  | Yes    | IRS      |
| <i>Spicko v. Comm’r</i> , T.C. Memo. 2016-41  | 6651(a)(1),(2) – No reasonable cause  | Yes    | IRS      |
| <i>Stout v. Comm’r</i> , T.C. Memo. 2015-133, appeal docketed, No. 16-1212 (6th Cir. Feb. 19, 2016)   | 6651(a)(1) – Taxpayer failed to show ordinary business care and prudence                            | Yes    | IRS      |
| <i>Whittington v. Comm’r</i> , T.C. Memo. 2015-152  | 6651(a)(1),(2) – No reasonable cause<br>6654 – No exceptions apply                                  | Yes    | IRS      |
| <i>Vaughn v. US</i> , 116 A.F.T.R.2d (RIA) 7022 (6th Cir. 2015), <i>aff’g</i> 34 F. Supp. 3d 773 (N.D. Ohio 2014)                                     | 6651(a)(1)– Reliance on tax professionals did not establish reasonable cause                        | No     | IRS      |
| <b>Business Taxpayers (Corporations, Partnerships, Trusts and Sole Proprietorships – Schedules C, E, F)</b>   |   |        |          |
| <i>Akey v. Comm’r</i> , T.C. Memo. 2015-227   | 6651(a)(1),(2) – Illness and break-in did not establish reasonable cause                            | Yes    | IRS      |
| <i>Arizaga v. Comm’r</i> , T.C. Memo. 2016-57   | 6651(a)(1) – Taxpayer offered no reasonable cause argument  | Yes    | IRS      |
| <i>Elick v. Comm’r</i> , 638 F. App’x 609 (9th Cir. 2016), <i>aff’g</i> T.C. Memo. 2013-139, <i>cert. denied</i> , No. 15-1290 (May 16, 2016)         | 6651(a)(1) – Reliance on tax professional did not establish reasonable cause                        | No     | IRS      |
| <i>Epitome Sys., Inc. v. Comm’r</i> , T.C. Memo. 2015-108   | 6651(a)(1),(2) – Taxpayer offered no reasonable cause argument                                      | No     | IRS      |
| <i>Grossnickle v. Comm’r</i> , T.C. Memo. 2015-127  | 6651(a)(1) – Lack of knowledge regarding filing requirements does not establish reasonable cause    | Yes    | IRS      |
| <i>Jasperson v. Comm’r</i> , T.C. Memo. 2015-186, <i>aff’d</i> by 118 A.F.T.R.2d (RIA) 5633 (11th Cir. 2016)  | 6651(a)(1) – No reasonable cause  | No     | IRS      |
| <i>Kavuma v. Comm’r</i> , T.C. Memo. 2016-101   | 6651(a)(1) – No reasonable cause  | Yes    | IRS      |
| <i>Kornhauser v. Comm’r</i> , 632 F. App’x 421 (9th Cir. 2016), <i>aff’g</i> T.C. Memo. 2013-230  | 6651(a)(1) – No reasonable cause<br>6654 – No exceptions apply                                      | Yes    | IRS      |
| <i>Lawson v. Comm’r</i> , T.C. Memo. 2015-211   | 6651(a)(1) – Taxpayer offered no reasonable cause argument  | Yes    | IRS      |
| <i>Non Profit Ins. Program v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1427 (E.D. Wash. 2016), <i>appeal dismissed</i> , No. 16-35379 (9th Cir. June 27, 2016) | 6654 – No exceptions apply  | No     | IRS      |
| <i>Nutrition Formulators, Inc. v. Comm’r</i> , T.C. Memo. 2016-60   | 6651(a)(1),(2) – No reasonable cause  | No     | IRS      |
| <i>Philbrick v. Comm’r</i> , T.C. Memo. 2016-064  | 6651(a)(1) – No reasonable cause  | Yes    | IRS      |
| <i>Polowniak v. Comm’r</i> , T.C. Memo. 2016-31   | 6651(a)(1),(2) – Taxpayer offered no reasonable cause argument                                      | No     | IRS      |
| <i>Porter v. Comm’r</i> , T.C. Memo. 2015-122   | 6651(a)(2) – No reasonable cause<br>6654 – No exceptions apply                                      | Yes    | IRS      |
| <i>Scott Labor, LLC v. Comm’r</i> , T.C. Memo. 2015-194   | 6651(a)(1) – Taxpayer had no filing requirement<br>6651(a)(2) – Taxpayer underpaid employment taxes | No     | Split    |
| <i>Stuller v. U.S.</i> , 811 F.3d 890 (7th Cir. 2016), <i>aff’g</i> 110 A.F.T.R.2d (RIA) 5766 (C.D. Ill. 2012)  | 6651(a)(1) – Taxpayer failed to show ordinary business care and prudence                            | No     | IRS      |
| <i>West v. Comm’r</i> , 141 F. Supp. 3d 498 (E.D. Va. 2015)   | 6651(a)(1),(2) – Reliance on tax professional did not establish reasonable cause                    | No     | IRS      |

**TABLE 7 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403**

| Case Citation   | Issue(s)  | Pro Se | Decision |
|---|---|--------|----------|
| <b>Individual Taxpayers (But Not Sole Proprietorships)</b>  |   |        |          |
| <i>Adent, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1505 (7th Cir. 2016), <i>aff'g</i> 116 A.F.T.R.2d (RIA) 6536 (E.D. Wis. 2015)  | Affirmed lower court's decision to foreclose  | Yes    | IRS      |
| <i>Baker, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1475 (D.N.H. 2016)   | Default judgment against TP and third parties; Federal tax liens valid and foreclosed against TP's real property                      | Yes    | IRS      |
| <i>Born, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1177 (D. Alaska 2016)   | Federal tax liens valid and foreclosed against TP's (H&W) real property   | No     | IRS      |
| <i>Campbell, U.S. v.</i> , 2016 U.S. Dist. LEXIS 81521 (N.D. Fla. 2016), <i>adopting</i> 2016 U.S. Dist. LEXIS 81522 (N.D. Fla. 2016), <i>appeal docketed</i> , No. 16-16414 (11th Cir. Oct. 6, 2016) | Federal tax liens valid and foreclosed against TP's real property   | Yes    | IRS      |
| <i>Cobos, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6335 (N.D. Tex. 2015)  | Entry of default set aside without prejudice; TPs directed to answer government's complaint   | Yes    | TP       |
| <i>Gaiamo, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1058 (E.D. Mo. 2016), <i>appeal docketed</i> , No. 16-2479 (8th Cir. May 31, 2016)  | Federal tax liens valid and foreclosed against TP's real property   | No     | IRS      |
| <i>Goddard, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6260 (N.D. Tex. 2015)  | Default judgment against non-owner resident; Federal tax liens and foreclosure against TPs real property                              | Yes    | IRS      |
| <i>Hunter, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5044 (M.D. Fla. 2015)   | Federal tax liens valid and foreclosed against TP's (H&W) real property; Property held by nominee trust                               | No     | IRS      |
| <i>Jones, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6737 (D. Minn. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6733 (D. Minn. 2015), <i>appeal docketed</i> , No. 16-1034 (8th Cir. Jan. 6, 2016)            | Federal tax liens valid and foreclosed against TP's real property   | Yes    | IRS      |
| <i>Kim, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6511 (E.D. Cal. 2015)  | Federal tax liens valid and foreclosed against TP's (H&W) real property   | No     | IRS      |
| <i>McFarland, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5364 (S.D. Miss. 2015), <i>adopting</i> 114 A.F.T.R.2d (RIA) 6942 (S.D. Miss. 2014)  | Federal tax liens valid and foreclosed against TP's real property; Property deemed held by TP's son as nominee                        | No     | IRS      |
| <i>Mendoza v. Cisneros</i> , 116 A.F.T.R.2d (RIA) 6357 (D. Colo. 2015)  | Federal tax liens valid and foreclosed against TP's real property   | No     | IRS      |
| <i>Nipper, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5231 (D.N.M. 2015), <i>adopting</i> 889 F. Supp. 2d 1260 (D.N.M. 2012)  | Federal tax liens valid and foreclosed against TP's (H&W) real property   | No     | IRS      |
| <i>Plummer, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5713 (M.D.N.C. 2015)   | Federal tax liens valid and foreclosed against TP's real property   | Yes    | IRS      |
| <i>Reyes, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 705 (W.D. Tenn. 2016)  | Default judgment against TPs (co-owners both with tax liabilities); Federal tax liens valid and foreclosed against TP's real property | Yes    | IRS      |
| <i>Rivera, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5061 (D.N.M. 2015)  | Federal tax liens valid and foreclosed against TP's (H&W) real property   | Yes    | IRS      |
| <i>Sorenson, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1245 (D. Utah 2016)   | Federal tax liens valid and foreclosed against TP's real property   | Yes    | IRS      |
| <i>Staton, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5947 (D. Haw. 2015)   | Federal tax liens valid and foreclosed against TP's (H&W) real property   | Yes    | IRS      |

TABLE 7: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

| Case Citation   | Issue(s)  | Pro Se | Decision |
|---|---|--------|----------|
| <i>TPF Deeds, LLC v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6427 (D. Utah 2015)  | Federal tax liens valid, superior to plaintiff's interests, and foreclosed against TP's one-third interest in real property             | No     | IRS      |
| <b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedule C, E, F)</b>   |   |        |          |
| <i>Davis, U.S. v.</i> , 815 F.3d 253 (6th Cir. 2016), <i>aff'g</i> 114 A.F.T.R.2d (RIA) 6019 (E.D. Mich. 2014)  | Federal tax liens valid and foreclosed against TP's (H&W) jointly held real property  | No     | Split    |
| <i>Enright, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6380 (M.D. Fla. 2015), <i>adopting</i> 2014 U.S. Dist. LEXIS 160148 (M.D. Fla. 2014)   | Federal tax liens valid and foreclosed against TP's real property; Property held by nominee trust                                       | Yes    | IRS      |
| <i>Fields, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1044 (D.N.M. 2016)  | Federal tax liens valid and foreclosed against TP's (H) half interest in jointly owned real property                                    | Yes    | IRS      |
| <i>Fraughton, U.S. v.</i> , 115 A.F.T.R.2d (RIA) 2202 (D. Utah 2015), <i>adopting</i> 2015 U.S. Dist. LEXIS 80076 (D. Utah 2015), <i>aff'd on appeal</i> , docket No. 15-4103 (10th Cir. Jan. 29, 2016) | Federal tax liens valid and foreclosed against TP's real property   | Yes    | IRS      |
| <i>Hounsom, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6120 (M.D. Fla. 2015)  | Federal tax liens valid and foreclosed against TP's real property; Property held by TP's corporate nominee                              | No     | IRS      |
| <i>Lake Las Vegas Master Trust v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1150 (D. Nev. 2016), <i>appeal docketed</i> , No. 16-15725 (9th Cir. Apr. 20, 2016)   | Federal tax liens valid and foreclosed against TP's real property   | No     | IRS      |
| <i>Major, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 1869 (M.D. Fla. 2016)  | Federal tax liens valid and foreclosed against TP's (H&W) real property   | Yes    | IRS      |
| <i>Nichols, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6705 (E.D. Wash. 2015), <i>adopting</i> 115 A.F.T.R.2d (RIA) 1971 (E.D. Wash. 2015)  | Federal tax liens valid and foreclosed against TP's (H&W) real property; Property held by nominee trust                                 | No     | IRS      |
| <i>Sanders, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 738 (S.D. Ill. 2016), <i>appeal docketed</i> , No. 16-1830 (7th Cir. Apr. 15, 2016)  | Federal tax liens valid and foreclosed against TP's real property; Property held by nominee trust                                       | Yes    | IRS      |
| <i>Short, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 310 (M.D.N.C. 2015)  | Federal tax liens valid and foreclosed against TP's real property   | No     | IRS      |
| <i>Sollenberger, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 7032 (M.D. Pa. 2015)  | Federal tax liens valid and foreclosed against TP's (H&W, sons) real property; Trusts were nominees; Property held by corporate nominee | No     | IRS      |
| <i>Trowbridge, U.S. v.</i> , 117 A.F.T.R.2d (RIA) 894 (E.D. Tex. 2016), <i>adopting</i> 117 A.F.T.R.2d (RIA) 889 (E.D. Tex. 2016)   | Federal tax liens valid and foreclosed against TP's real property; Property held by corporate nominee                                   | Yes    | IRS      |
| <i>Wilkins, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 5466 (M.D. Fla. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 5463 (M.D. Fla. 2015), <i>appeal dismissed</i> , No. 15-14346 (11th Cir. Mar. 29, 2016)      | Federal tax liens valid and foreclosed against TP's real property; Property held by corporate nominee                                   | Yes    | IRS      |

**TABLE 8 Charitable Contributions Under IRC § 170**

| Case Citation  | Issue(s)  | Pro Se | Decision |
|--|---|--------|----------|
| <b>Individual Taxpayers (But Not Sole Proprietorships)</b>   |   |        |          |
| <i>Barnes v. Comm'r</i> , T.C. Memo. 2016-79   | Non-cash contributions unsubstantiated  | Yes    | IRS      |
| <i>Beltifa v. Comm'r</i> , T.C. Summ. Op. 2016-8   | Cash and non-cash contributions unsubstantiated   | Yes    | IRS      |
| <i>Britto-Bernstein v. Comm'r</i> , T.C. Summ. Op. 2016-3  | Cash contribution unsubstantiated   | Yes    | IRS      |
| <i>Brown v. Comm'r</i> , T.C. Memo. 2016-39  | Cash contributions unsubstantiated  | Yes    | IRS      |
| <i>Carroll v. Comm'r</i> , 146 T.C. No. 13 (2016)  | Conservation easement did not have a conservation purpose protected in perpetuity   | No     | IRS      |
| <i>Chaudry v. Comm'r</i> , T.C. Summ. Op. 2015-74  | Cash and non-cash contributions substantiated in part, unsubstantiated in part  | Yes    | Split    |
| <i>Dimarco, Estate of, v. Comm'r</i> , T.C. Memo. 2015-184, <i>appeal dismissed</i> , No. 15-4154 (2d Cir. Aug. 8, 2016)   | Estate residue was not permanently set aside for charitable purpose   | No     | IRS      |
| <i>Garcia v. Comm'r</i> , T.C. Memo. 2016-21   | Cash contribution substantiated, other cash and non-cash contributions unsubstantiated  | Yes    | Split    |
| <i>Gemperle v. Comm'r</i> , T.C. Memo. 2016-1  | Façade conservation easement contribution denied for failure to include qualified appraisal   | Yes    | IRS      |
| <i>Henao v. Comm'r</i> , T.C. Summ. Op. 2016-7   | Cash contributions unsubstantiated  | No     | IRS      |
| <i>Minnick v. Comm'r</i> , 796 F.3d 1156 (9th Cir. 2015), <i>aff'g</i> T.C. Memo. 2012-345   | Conservation easement not granted in perpetuity   | No     | IRS      |
| <i>Wesley v. Comm'r</i> , T.C. Memo. 2015-200  | Cash contributions unsubstantiated  | Yes    | IRS      |
| <i>Zavadil v. Comm'r</i> , 793 F.3d 866 (8th Cir. 2015), <i>aff'g</i> T.C. Memo. 2013-222  | Contributions made with money advanced by corporation not deductible by TPs (H&W)   | No     | IRS      |
| <b>Business Taxpayers (Corporate, Partnerships, Trusts, and Sole Proprietorships - Schedules C, E, F)</b>  |   |        |          |
| <i>Atkinson v. Comm'r</i> , T.C. Memo. 2015-236, <i>appeal docketed</i> , No. 16-2083 (4th Cir. Sept. 21, 2016) & No. 16-16124 (11th Cir. Sept. 21, 2016)                  | Conservation easements did not have “conservation purposes”   | No     | IRS      |
| <i>Beaubrun v. Comm'r</i> , T.C. Memo. 2015-217  | Cash contributions substantiated in part  | No     | Split    |
| <i>Bosque Canyon Ranch, L.P. v. Comm'r</i> , T.C. Memo. 2015-130, <i>appeal docketed</i> , No. 16-60069 (5th Cir. Jan. 28, 2016)   | Conservation easements were not “qualified real property interests”   | No     | IRS      |
| <i>Dieringer, Estate of, v. Comm'r</i> , 146 T.C. No. 8 (2016), <i>appeal docketed</i> , No. 16-72640 (9th Cir. Aug. 8, 2016)  | Date of death valuation of charitable contribution not appropriate when subsequent actions reduced the value of the contribution prior to its transfer to the charitable foundation | No     | IRS      |
| <i>French v. Comm'r</i> , T.C. Memo. 2016-53   | Conservation easement not acknowledged in contemporaneous writing; Failed strict substantiation test  | No     | IRS      |
| <i>Green v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6668 (W.D. Okla. 2015)   | Fair market value at time of donation appropriate for value of donated properties   | No     | TP       |
| <i>Isaacs v. Comm'r</i> , T.C. Memo. 2015-121  | Non-cash contributions unsubstantiated; Value of donated fossils required qualified appraisals  | Yes    | IRS      |
| <i>Mecox Partners LP v. U.S.</i> , 117 A.F.T.R.2d (RIA) 593 (S.D.N.Y. 2016)  | Conservation easement denied for failure to include timely appraisal  | No     | IRS      |
| <i>Palmer Ranch Holdings Ltd. v. Comm'r</i> , 812 F.3d 982 (11th Cir. 2016), <i>aff'g in part, rev'g in part, and remanding for further proceedings</i> T.C. Memo. 2014-79 | Valuation of conservation easement  | No     | TP       |

TABLE 8: Charitable Contributions Under IRC § 170

| Case Citation  | Issue(s)  | Pro Se | Decision |
|--|---|--------|----------|
| <i>Porter v. Comm’r</i> , T.C. Memo. 2015-122  | Contributions allowed on Schedule A, not Schedule C   | Yes    | TP       |
| <i>RP Golf, LLC v. Comm’r</i> , T.C. Memo. 2016-80, <i>appeal docketed</i> , No. 16-3277 (8th Cir. Aug. 3, 2016) | Conservation easement not granted in perpetuity       | No     | IRS      |
| <i>Schaefer, Estate of, v. Comm’r</i> , 145 T.C. 134 (2015)  | Valuation of remainder interests of charitable trusts | No     | IRS      |
| <i>Strode v. Comm’r</i> , T.C. Memo. 2015-117  | Cash contributions substantiated in part              | No     | Split    |

**TABLE 9 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions**

| Case Citation   | Issue(s)  | Pro Se | Decision                              | Amount   |
|---|---|--------|---------------------------------------|----------|
| <b>Individual Taxpayers (But not Sole Proprietorships)</b>  |   |        |                                       |          |
| <i>Berglund v. Comm'r</i> , T.C. Memo. 2015-239   | TP petitioned for review of IRS decision to uphold a proposed levy and NFTL   | Yes    | TP                                    |          |
| <i>Briggs v. Comm'r</i> , T.C. Memo. 2016-86  | TPs (H&W) petitioned for redetermination of deficiency and penalty and asserted that their Fifth Amendment rights were denied, they disputed the receipt of wages from non-government payers, claimed they were denied due process under the Fourteenth Amendment, stated the payers of their wages were not employers, and that they were not employees, and other frivolous arguments | Yes    | IRS                                   | \$3,000  |
| <i>Bruhiler v. Comm'r</i> , T.C. Memo. 2016-18  | TP petitioned for redetermination of deficiency and additions to tax and asserted that the definition of income is a cat with a pink bow, he earned no income, he is his own jurisdiction, not a part of legal society, and has his own society   | Yes    | IRS                                   | \$3,500  |
| <i>Foryan v. Comm'r</i> , T.C. Memo. 2015-114   | TP petitioned for redetermination of deficiency and additions to tax and argued that Congress has passed no law requiring taxes to be filed and paid and payments he received were not income   | Yes    | IRS                                   | \$1,000  |
| <i>Hare v. Comm'r</i> , T.C. Memo. 2015-250   | TP petitioned for redetermination of IRS decision to file an NFTL and maintained proceedings primarily for delay  | Yes    | TP                                    |          |
| <i>Leyshon v. Comm'r</i> , T.C. Memo. 2015-104, <i>aff'd by appeal</i> , docket No. 15-2020 (4th Cir. May 20, 2016) | TP petitioned for redetermination of deficiency and additions to tax and argued that wages are not taxable income, that there was no valid determination and that the IRS did not have authority to make a determination  | Yes    | IRS                                   | \$2,000  |
| <i>Martens v. Comm'r</i> , T.C. Memo. 2015-213  | TP petitioned for redetermination of IRS decision to proceed with collection actions  | Yes    | TP                                    |          |
| <i>Nitschke v. Comm'r</i> , T.C. Memo. 2016-78  | TP petitioned for redetermination of deficiency and additions to tax and asserted frivolous arguments   | Yes    | IRS                                   | \$10,000 |
| <i>Stanley v. Comm'r</i> , T.C. Memo. 2016-26   | TPs (H&W) petitioned for review of IRS decision to proceed with levies and liens and instituted proceedings primarily for delay   | Yes    | Split: TP (H) fined and TP (W) warned | \$10,000 |
| <i>Waltner v. Comm'r</i> , T.C. Memo. 2015-146, <i>appeal docketed</i> , No. 16-71797 (9th Cir. June 7, 2016)       | TPs (H&W) petitioned for review of IRS decision to proceed with levy and asserted frivolous arguments   | Yes    | IRS                                   | \$15,000 |
| <b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)</b>        |   |        |                                       |          |
| <i>Boring v. Comm'r</i> , T.C. Summ. Op. 2015-68  | TPs (H&W) petitioned for redetermination of deficiency and penalty and asserted frivolous arguments   | Yes    | TP                                    |          |
| <b>Section 6673 Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments</b>      |   |        |                                       |          |
| <i>Crummey v. Comm'r</i> , T.C. Memo. 2016-9, <i>appeal docketed</i> , No. 16-60620 (5th Cir. Sept. 16, 2016)       | TP petitioned for redetermination of penalties and additions to tax   | Yes    |                                       |          |



TABLE 9: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

| Case Citation   | Issue(s)  | Pro Se | Decision | Amount        |
|---|---|--------|----------|---------------|
| <i>Shakir v. Comm'r</i> , T.C. Memo. 2015-147   | TP petitioned for redetermination of deficiency and additions to tax and asserted that his income is not taxable, IRS forms violate the Paperwork Reduction Act, and the IRS lacks the authority to prepare a substitute for return and make a deficiency determination based on it | Yes    |          |               |
| US Courts of Appeals' Decisions on Appeal of Section 6673 Penalties Imposed by US Tax Court   |   |        |          |               |
| <i>Balice v. Comm'r</i> , 634 F. App'x 349 (3d Cir. 2016), <i>aff'g</i> T.C. Memo. 2015-46, <i>petition for cert. denied</i> , No. 15-9781 (Oct. 3, 2016) | Penalty affirmed  | Yes    | IRS      |               |
| <i>Curtis v. Comm'r</i> , 117 A.F.T.R.2d (RIA) 1347 (9th Cir. 2016), <i>aff'g</i> T.C. Memo. 2013-12  | Penalty affirmed  | Yes    | IRS      |               |
| <i>Kanofsky v. Comm'r</i> , 618 F. App'x 48 (3d Cir. 2015), <i>aff'g</i> T.C. Memo. 2014-153  | Penalty affirmed  | Yes    | IRS      |               |
| <i>Leyshon v. Comm'r</i> , 117 A.F.T.R.2d (RIA) 1776 (4th Cir. 2016), <i>aff'g</i> T.C. Memo. 2015-104  | Penalty affirmed  | Yes    | IRS      |               |
| <i>Myers v. Comm'r</i> , 630 F. App'x 207 (4th Cir. 2016), <i>aff'g</i> T.C. docket No. 30321-13 (May 28, 2015)   | Penalty affirmed  | Yes    | IRS      |               |
| <i>Rader v. Comm'r</i> , 616 F. App'x 391 (10th Cir. 2015), <i>aff'g in part and dismissing in part</i> 143 T.C. 376 (2014)                               | Penalty affirmed  | Yes    | IRS      |               |
| Other US Courts' Decisions on Sanctions Under Section 7482 (c)(4), FRAP Rule 38, or Other Authority   |   |        |          |               |
| <i>Clark, U.S. v.</i> , 642 F. App'x 614 (7th Cir. 2016), <i>aff'g</i> 116 A.F.T.R.2d (RIA) 5229 (E.D. Wis. 2015)   | TP appealed the District Court's upholding of the IRS's right to collect unpaid taxes and argued that the income tax is unconstitutional  | Yes    | IRS      | \$4,000       |
| <i>Myers v. Comm'r</i> , 630 F. App'x 207 (4th Cir. 2016), <i>aff'g</i> T.C. docket No. 30321-13 (May 28, 2015)   | TP appealed Tax Court's upholding of IRS levy action  | Yes    | TP       |               |
| <i>Scherer, U.S. v.</i> , 116 A.F.T.R.2d (RIA) 6102 (S.D. Ohio 2015)  | The U.S. filed a motion for sanctions against TP for maintaining proceedings for delay; Sanctions awarded on the grounds of the second count but not the first count  | No     | Split    | \$10,000      |
| <i>Widtfeldt v. U.S.</i> , 122 Fed. Cl. 158 (2015), <i>aff'd by appeal</i> , docket No. 15-5128 (Fed. Cir. Oct. 12, 2016)                                 | TP sued the U.S. for a refund of death and gift taxes associated with his now deceased mother   | Yes    | IRS      | Costs awarded |
| Section 7482 (c)(4), FRAP Rule 38, or Other Authority Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments          |   |        |          |               |
| <i>Noll v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6170 (D. Idaho 2015), <i>appeal denied</i> , No. 15-72797 (9th Cir. Nov. 20, 2015)                             | Motion by the U.S. to declare TP a vexatious litigant; TP prohibited from filing any civil pleadings challenging the assessment or collection of federal income taxes   | Yes    |          |               |

**TABLE 10 Trust Fund Recovery Penalty Under IRC § 6672**

| Case Citation   | Issue(s)  | Pro se | Decision |
|---|---|--------|----------|
| <i>Appelbaum, v. U.S.</i> , 117 A.F.T.R.2d (RIA) 633 (W.D.N.C. 2016), <i>appeal docketed</i> , No. 16-1949 (4th Cir. Aug. 19, 2016)   | Notice requirement was not satisfied and assessment not valid   | No     | TP       |
| <i>Behrman v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1295 (E.D. Tex. 2016)   | TP was a responsible person who willfully failed to pay the tax owed; Summary judgment granted  | Yes    | IRS      |
| <i>Byrne v. U.S.</i> , 116 A.F.T.R.2d (RIA) 5502 (E.D. Mich. 2015), <i>appeal docketed</i> , No. 15-2396 (6th Cir. Nov. 16, 2015)   | TPs were responsible persons who willfully failed to pay the tax owed; Exhibited recklessness   | No     | IRS      |
| <i>Cherne, In re</i> 116 A.F.T.R.2d (RIA) 6235 (D. Idaho 2015), <i>aff'g</i> 514 B.R. 616 (Bankr. Idaho 2014), <i>appeal docketed</i> , No. 15-35802 (9th Cir. Oct. 19, 2015) | TP was a responsible person who willfully failed to pay the tax owed; Encumbered assets exception did not apply   | No     | IRS      |
| <i>Crews, v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6278 (D.S.C. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6273 (D.S.C. 2015)  | TP was responsible person who willfully failed to pay the tax owed; Summary judgment granted; Tax liabilities reduced to judgment   | Yes    | IRS      |
| <i>DeCrescenzo v. U.S.</i> , 117 A.F.T.R.2d (RIA) 734 (C.D. Cal. 2016)  | TP was a responsible person who willfully failed to pay the tax owed; Summary judgment granted  | No     | IRS      |
| <i>Hasbun v. U.S.</i> , 116 A.F.T.R.2d (RIA) 5759 (S.D. Fla. 2015)  | TPs were responsible persons who willfully failed to pay the tax owed; Reasonable cause argument failed   | No     | IRS      |
| <i>Karban v. U.S.</i> , 117 A.F.T.R.2d (RIA) 1214 (E.D. Mich. 2016), <i>appeal docketed</i> , No. 16-1606 (6th Cir. May 11, 2016)   | TP was a responsible person who willfully failed to pay the tax owed; Encumbered assets exception did not apply; Summary judgment granted   | No     | IRS      |
| <i>Obiakor v. Comm'r, T.C.</i> Memo. 2015-112   | Notice requirement satisfied and assessment valid; TP was responsible person who willfully failed to pay the tax owed   | No     | IRS      |
| <i>Romano-Murphy v. Comm'r</i> , 816 F.3d 707 (11th Cir. 2016) <i>rev'g and remanding</i> , T.C. Memo. 2012-330   | Upon TP's timely protest, IRS is required to provide a pre-assessment administrative determination of the proposed liability for trust fund taxes; Remanded to determine whether this error was harmless  | Yes    | TP       |
| <i>Rozbruch, v. U.S.</i> , 621 F. App'x 77 (2d Cir. 2015), <i>aff'g</i> 28 F. Supp. 3d 256 (S.D.N.Y. 2014)  | Notice requirement satisfied and assessment valid; TPs were responsible persons who willfully failed to pay the tax owed  | No     | IRS      |
| <i>Ruscitto v. U.S.</i> , 629 F. App'x 429 (3d Cir. 2015), <i>aff'g</i> 111 A.F.T.R.2d (RIA) 2166 (W.D. Penn. 2013)   | TP was a responsible person who willfully failed to pay the tax owed; Encumbered assets exception did not apply   | No     | IRS      |
| <i>Sabaratham, v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6441 (C.D. Cal. 2015), <i>appeal docketed</i> , No. 15-56463 (9th Cir. Sept. 23, 2015)                                      | TP was a responsible person who willfully failed to pay the tax owed; however, the TFRP liabilities based on the first and second quarters of 2000 required additional briefings to the court on the issue of statute of limitations; Government's summary judgment partially granted | Yes    | Split    |
| <i>Sabaratham, v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6459 (C.D. Cal. 2015), <i>appeal docketed</i> , No. 15-56463 (9th Cir. Sept. 23, 2015)                                      | TP was a responsible person who willfully failed to pay the tax owed; Exhibited recklessness; Summary judgment granted  | Yes    | IRS      |
| <i>Sananikone v. U.S.</i> , 623 F. App'x 324 (9th Cir. 2015), <i>aff'g</i> 111 A.F.T.R.2d (RIA) 1464 (E.D. Cal. 2013)   | Jury verdict affirmed on appeal that TP was a responsible person who willfully failed to pay the tax owed   | No     | IRS      |
| <i>Schiffmann v. U.S.</i> , 811 F.3d 519 (1st Cir. 2016), <i>aff'g</i> 114 A.F.T.R.2d (RIA) 6241 (D.R.I. 2014)  | TPs were responsible persons who willfully failed to pay the tax owed; Encumbered assets exception did not apply; Summary judgment granted  | No     | IRS      |
| <i>Troost v. U.S.</i> , 116 A.F.T.R.2d (RIA) 6043 (N.D. Tex. 2015), <i>adopting</i> 116 A.F.T.R.2d (RIA) 6039 (N.D. Tex. 2015)  | TPs were responsible persons who willfully failed to pay the tax owed; Exhibited recklessness; Summary judgment granted   | Yes    | IRS      |

TABLE 10: Trust Fund Recovery Penalty Under IRC § 6672

| Case Citation   | Issue(s)   | Pro se | Decision |
|---|--|--------|----------|
| <i>Wallis, v. U.S.</i> , 117 A.F.T.R.2d (RIA) 583 (W.D. Va. 2016)   | TP was a responsible person who willfully failed to pay the tax owed for two companies; Genuine dispute of material fact prohibited court from granting summary judgment in regards to third company | No     | Split    |
| <i>Waterhouse v. U.S.</i> , 122 Fed. Cl. 276 (2015)                 | TP was a responsible person who willfully failed to pay the tax owed   | No     | IRS      |
| <i>Wheeler v. U.S.</i> , 116 A.F.T.R.2d (RIA) 5191 (E.D. Ky. 2015)  | TP was a responsible person who willfully failed to pay the tax owed; Motion for partial summary judgment granted  | No     | IRS      |
| <i>Whigham v. U.S.</i> , 116 A.F.T.R.2d (RIA) 7000 (S.D. Ala. 2015) | TP was a responsible person who willfully failed to pay the tax owed   | No     | IRS      |

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